IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

Supreme Court, U.S.
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Docket No.

WALTER HOLYK, KENNETH H. DARKE and RICHARD H. CLAYTON,

71 - 347

Petitioners,

-against-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Warren E. Burger, Chief Justice, and the Honorable Associate Justices of the Supreme Court of the United States:

Your petitioners Walter Holyk, Kenneth H. Darke, and Richard H. Clayton pray that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit for a review of the judgment entered against petitioners, among others, in Securities and Exchange Commission v. Texas Gulf Sulphur Company et al., on June 10, 1971.

OPINIONS BELOW

The opinion and judgment of the United States District Court, Southern District of New York (Bonsal, J.) in favor of petitioners, except as to certain transactions of Mr. Clayton is reported at 258 F. Supp. 262 and at Appendix, p. 1a.* The opinion of Judge Waterman for the Second Circuit Court of Appeals, en banc, concurred in, in whole or in part, by six other judges of that Court, reversing the judgment of the District Court and remanding the case for further proceedings, and the dissenting opinion of Judge Moore, concurred in by Chief Judge Lumbard, are reported at 401 F. 2d 833, 970 and at Appendix, pp. 66a and 129a.

*Reference in this form are to the separately bound appendix filed by Orison S. Marden, Esq., on behalf of Petitioners Texas Gulf Sulphur Company, Fogarty, Mollison, Stephens and Kline.

The opinion on remand of the District Court, (Bonsal, J.) is reported at 312 F. Supp. 77, (1970) and at Appendix, p. 175a. Judge Waterman's opinion for the Second Circuit Court of Appeals, concurred in by Chief Judge Friendly and Judge Hays, which opinion is not yet officially reported, appears at Appendix p. 220a.

JURISDICTION

The judgment of the Court of Appeals was entered on June 10, 1971. The statutory provision conferring jurisdiction on this Court is found at 62 Stat. 928, 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether, within the meaning of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, information possessed by an insider is "material":

> (a) where it would be of interest to a speculator and, if disclosed, might affect the value of the corporation's security in any degree?
>
> or
>
> (b) where a reasonable man would attach importance to it, and, if disclosed, might affect the value of the corporation's security in a significant degree?

2. Whether it was error for the Court of Appeals to reject findings of the District Court, based on the "virtually uncontradicted testimony" of expert witnesses, as to the insignificance to a reasonable investor of a single exploratory drill hole to a company with 10,000,000 outstanding shares of stock, and to substitute its own findings as to the results of that single hole?

3. Whether it was error to grant restitution as an ancillary remedy for which no provision is made under Section 21(e) of the Securities Exchange Act of 1934?

4. Whether the restitutionary relief granted was an assessment of a penalty which the Court was not empowered to levy?

5. Whether the granting of a substantive relief in a prophylactic proceeding violated petitioners' rights under the due process clause of the Fifth Amendment and their rights to jury trials under the Sixth and Seventh Amendments?

6. Whether the order of restitution requiring Mr. Darke to restore to TGS profits made by his tippees can be sustained absent any legal basis?

7. Whether the District Court abused its discretion in enjoining Mr. Clayton in the absence of any finding that there was a reasonable likelihood that he would violate the Act in the future?

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

Constitution of the United States, Amendments VI and VII appear at p. 1 of the Addendum to this petition.

48 Stat. 891, 900; 15 U.S.C. Sections 78j(b), 78u(e) are set forth at Appendix B, pp 235a and 236a.

17 C.F.R. Sections 240.10b-5 and 240.12b-2(j) are set forth at pp. 238a and 239a, Appendix B.

STATEMENT OF THE CASE

A. THE CHARGE AGAINST MESSRS. HOLYK, DARKE AND CLAYTON

Respondent filed its complaint in the United States District Court for the Southern District of New York on April 19, 1965, charging petitioners and eleven others with violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78) (the "Act") and of Rule 10b-5 promulgated thereunder. Respondent sought an injunction under Section 21(e) of the Act and additional relief. Jurisdiction of the District Court was invoked under Section 27.

The charges arise from a mineral exploration program begun by Texas Gulf Sulphur Company ("Texas Gulf" or "TGS") in Canada in 1957. In the course of that program an exploratory hole was drilled

near Timmins, Ontario in November of 1963 in an area denominated Kidd 55. Respondent claimed that eleven of the individual defendants "having knowledge and information of material facts concerning the result of * * * Texas Gulf's drilling * * * which facts were not generally known to the investing public" either purchased shares of Texas Gulf stock or recommended their purchases to others.

B. FACTS REGARDING PETITIONERS HOLYK, DARKE AND CLAYTON

The uncontroverted facts are that Messrs. Holyk, Darke and Clayton purchased shares or calls on shares of Texas Gulf stock between November 12, 1963 and April 9, 1964. Mr. Darke had also advised others to purchase Texas Gulf stock during this period and purchases were allegedly made pursuant to his advice. The inforamtion known by Messrs. Holyk, Darke and Clayton during this period is not in dispute. It is the "materiality" of this information which is the crux of this case.

All the information known was contained in a core visually examined on November 12, 1963 by Messrs. Holyk and Darke, Texas Gulf giologists. This core resulted from the drilling on November 8, 1963 of an exploratory hole on property referred to as Kidd 55. This initial visual examination indicated a very favorable mineral content, which was later

confirmed when the core was assayed by the Texas Gulf laboratory. Except for the results of the chemical assay, no other knowledge of the possible value of the drilled area was available.

Although laboratory results proved favorable, experts for both sides, as the trial court aptly said, "agreed that one drill core does not establish an ore body, much less a mine." Indeed, "Defendants' experts unanimously concluded that there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body." 258 F. Supp. at 282, and at p. 29a Appendix A.

On March 31, 1964 Texas Gulf commenced an intensive drilling program in the area of Kidd 55. Existence of a mine was established on April 15, 1964.

C. THE DECISION BELOW

1. The First District Court Opinion

The District Court held that the drilled core information known by Messrs. Holyk, Darke and Clayton when they purchased Texas Gulf stock prior to April 9, 1964 was not material information. As Judge Bonsul said:

> "When considered in relation to the far-flung business of TGS at the time, it cannot be said that the drilling results of K-55-1 and K-55-3 constituted material information, the

> disclosure of which would have had a substantial impact on the market price of TGS's 10,000,000 outstanding shares." (29a)
>
> "The most that can be said of the individual defendants' knowledge after the drilling of K-55-1 is that they had 'hopes, perhaps with some reason,' that it would lead to a mine. James Blackstone Mem. Lib. Ass'n v. Gulf M.& O.R.Co., 264 F. 2d 445, 450 (7th Cir. 1959). The results of K-55-1 were too 'remote' when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any significant impact on the market, i.e., to be deemed material. List v. Fashion Park, Inc., supra." (30a).

Accordingly, purchases made by Messrs. Holyk, Darke and Clayton prior to April 9, 1971, when, as Judge Bonsal said "there was real evidence that a body of commercially mineable ore might exist" (28a,29a), were held not to be in violation of the Act. A purchase made by Mr. Clayton after this date was deemed violative of the Act.

2. First Court of Appeals Opinion

The Court of Appeals, reversing the District Court and holding that the core information known prior to April 9, 1964 was material, remanded the case for application of the appropriate remedies. (118a).

In reaching its decision the Court of Appeals expanded the facts and ignored the expert testimony in the record. As the dissenting judges noted, the majority substituted their own geological conclusions by stating that the initial drill core indicated a "more than marginal" possibility of the existence of a mine of "vast magnitude" (89a). The Court of Appeals then lowered the threshold of materiality to a new level by asserting that "material" facts are any "which may affect the desire of investors to buy, sell or hold the company's securities" (88a), defining "investors" to include "the speculators and chartists of Wall and Bay Streets" (87a), and concluding that the results of the first drill hole, if disclosed, "may" have affected the desires of such persons and "might" have affected stock prices.

3. Second District Court Opinion

On remand the District Court found that Mr. Holyk could not have anticipated the extension of "materiality" to cover his acts and refused to issue an injunction p. 90 (196a). Nonetheless, it ordered him to pay TGS the sum of $35,663.47, representing the difference between his purchase price for 550 shares and calls on 1200 shares and their market price on April 17, 1964 (208a).

On remand, Mr. Darke was ordered to pay Texas Gulf $41,794.92 for his purchases but he was not enjoined because he was no

longer employed by TGS (204a). Mr. Darke, who was held to have advised others to purchase TGS stock (94a), was also ordered to pay TGS $48,404.58, representing profits purportedly made by three such persons (207a).

On remand, Mr. Clayton was ordered to pay $20,010.56 to TGS and was also enjoined from making purchases or sales of TGS securities on the basis of material undisclosed information, despite any finding that there was a reasonable likelihood of such actions (209a, 197a).

All of the above ordered payments, which bear interest at the rate of 6% per annum from April 17, 1964, are to be paid to TGS. Such sums are to be held by Texas Gulf in an interest-bearing escrow account subject to such disposition as the court might direct. Any undisposed monies would become the property of TGS (203a).

4. The Second Court of Appeals Decision

The second appeal to the Court of Appeals was restricted to issues concerning appropriateness of remedies adapted by the District Court. The Court of Appeals held that the Securities and Exchange Commission ("SEC") may seek other than injunctive relief in an action commenced pursuant to Section 21(e) of the Act provided such relief is remedial and not a penalty assessment (227a). The Court of Appeals also held that the District Court did not abuse its discretion in issuing an injunction with respect to Mr. Clayton (226a).

REASONS FOR ALLOWANCE OF THE WRIT

1. The Court of Appeals has decided questions of federal substantive law under the securities laws, which are of great importance and wide application to corporate personnel and the public generally. In particular, the Court of Appeals has created tests of "materiality" in the context of the Act which are unworkable, have created widespread confusion in the business community and which conflict with the SEC's own longstanding regulations and with standards adopted by the Seventh Circuit and by the Second Circuit itself in previous decisions.

2. The Court of Appeals has departed from the accepted and usual course of judicial proceeding by overturning and ignoring finds of fact of the District Court contrary to Rule 52(a) of the Federal Rules of Civil Procedure.

3 The Court of Appeals has, in conflict with a decision of the Ninth Circuit, ordered ancillary relief which goes beyond statutory authority and the exercise of federal equity powers as defined by this Court and is violative of petitioners constitutional rights.

ARGUMENT I

THE COURT OF APPEALS ERRED IN REVERSING THE DISTRICT COURT'S DECISION THAT THE UNDISCLOSED INFORMATION POSSESSED BY PETITIONERS WAS NOT MATERIAL AND ESTABLISHING A NEW TEST FOR DETERMINING MATERIALITY*

Petitioners liability is predicated on whether the preliminary drill core information they possessed was "material" within the meaning of Rule 10b-5 of the Act. The District Court held that the information was not material. By a divided court the Court of Appeals held otherwise. To reach its decision the Court of Appeals came to a different conclusion regarding the facts and lowered the threshold of materiality by replacing reasonable reflection with mere speculation and the probability of market impact with a may-be. In so doing it created a standard of materiality not only at variance with prior cases and SEC regulations, but a standard of hindsight evaluation providing the corporate insider with no reasonable guidance.

Both courts said that material information is that 'which in reasonable and objective contemplation might affect the value of the corporation's stock or securities ..."List v. Fashion Park, Inc., 340 F 2d 457, 462 (2d Cir.); the contemplator being the well established reasonable man or prudent investor. List v.

* The issues discussed under this argument only concern the first opinions of the District Court and Court of Appeals.

Fashion Park, Inc. Id. This definition is essentially the same as the SEC's which defines material information as "those matters as to which an average prudent investor ought reasonably to be informed before buying or selling ..." Rule 12b-2 (j) (17 C.F.R. Section 240 12b-2(j) (239a). The standard used by the courts and the SEC has been the investment judgment of a reasonable man.

To avoid the strict application of that standard and yet stay within the List doctrine, the Court of Appeals simply expanded the scope of the reasonable man. In saying that "speculators and chartists of Wall and Bay Streets are also 'reasonable' investors ...", the Court reduced the standard to the investment judgment of the speculative trader to whom any information would be material (87a). Within this altered definition, any information could be deemed material if hindsight evaluation could find someone who thought it so.

The District Court realized this problem when it noted a second requirement - information is not material merely because it would be of interest to a speculator, it must also be such that, if disclosed, it would be "reasonably certain to have a substantial effect on the market price of the security" (29a). Within this parameter the District Court held that the results of the drilled hole :

> "were too 'remote' when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any

> significant impact on the market, i.e., to be deemed material. List v. Fashion Park, Inc., supra." (30a)

Although the Court of Appeals also seemingly recognized the necessity of showing a substantial or significant market impact (86a), it ignored this requirement holding that the drilled core results were material because they "might well have affected the price of RGS stock ..." (89a). The Court thereby reduced the required market impact from substantial or significant to "maybe any". When coupled with its "definition" of a reasonable man, the Court of Appeals' application of the market impact test expanded the concept of materiality far beyond previous limits.

A survey of the cases concerning insider transactions reveal the test of materiality has consistently been whether the undisclosed information would be important to a reasonable man in making his investment decision and whether that information, if disclosed, would have a significant effect on the value of the security involved.*

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* Taylor v. Janigan 212 F Supp. 794 (D.Mass 1962), modified and aff'd. sub nom. Janigan v. Taylor 344 F 2d 781 (1st Cir.1965); cert. denied, 382 U.S.879 (1965); Reed v. Riddle Airlines, 266 F 2d 314, 315 (5th Cir. 1959); Baumel v. Rosen, 283 F. Supp. 128, 141 (D.Md. 1968); Ross v. Licht, 263 F. Supp. 395 (S.D.N.Y.1966) appeal dismissed, 367 F. 2d 658 (2d Cir. 1966); Speed v. Transamerica Corp. 99 F. Supp. 808 (D. Del. 1951);

This test should not now be discarded for a standard which determines information material if it may be of interest to a speculator and might affect market value. If, as the Court of Appeals suggests, any degree of interest and impact, no matter how slight, is sufficient to render a fact material, no corporate employee investing in his company's stock would be free from doubt as to a future determination of Section 10 (b) liability. Due to the often harsh results of the Rule's application corporate insiders must have a more definite and realistic standard to guide their conduct.

II

THE COURT OF APPEALS ERRED IN DISREGARDING F. R. C. P. Rule 52 (a) BY ARRIVING AT FACTUAL CONCLUSIONS DIAMETRICALLY OPPOSED TO THE DISTRICT COURT'S

The Court of Appeals, by concluding that the results of the first hole constituted "material information", did not give the District Court findings the consideration and weight required by law. To reach their decision the majority ignored and overturned findings of fact by the trial judge, who based his appraisal upon the

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Footnote P.14-continued
Kardon v. National Gypsum Company 83 F. Supp. 613, 614 (E.D. Pa. 1949); Ward La France Truck Corp. 13 SEC 373 (1943); Mills v. Electric Auto-Lite Co. 396 U.S. 375, 384 (1970)

testimony of eleven expert witnesses and the study of numerous geological and geophysical exhibits and charts. As pointed out by the dissenters, the majority, in disregard of F.R. C.P. Rule 52(a), chose "to reject the trial court's finding as to the results of the first drill core, K-55-1, and to substitute their own expertise in the mining engineering field * * *"(135a). The District Court credited the "virtually uncontradicted testimony" of the experts (135a) to the effect that "one drill core does not establish an ore body, much less a mine" and that "there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body". In contrast, the majority of the Court of Appeals determined that the first hole showed the "possibility which surely was more than marginal of the existence of a mine of * * * vast magnitude * * *" (89a). This contrary conclusion was reached despite the Court's own statement that the "cleraly erroneous" rule was not applicable (89a).

The Court of Appeals in reaching this conclusion never referred to the distinguished experts called by defendants and credited by the District Judge, instead it relied heavily upon the deposition testimony of a Canadian penny stock speculator to support its geological and investment conclusions (90a). Certainly what is releveant to a speculator willing to place small sums on many penny stocks is not necessarily material to an investor. This distinction was acknow-

ledged by the District Court's conclusuion that "from an investment point of view, no significance could be attached to the results of a single drill hole" (30a). The Court of Appeals should be corrected in summarily dismissing the District Court's findings in this manner and ignoring the basic principles of appellate jurisdiction repeatedly stated by this Court (see,e.g., Graver Tank & Mfg. Co. Inc.v. Linde Air Prods. Co., 339 U.S. 605, 609-10 (1950).

III

THE ACT DOES NOT AUTHORIZE THE RESTITUTION OF PROFITS IN AN SEC ENFORCEMENT PROCEEDING NOR IS THIS REMEDY ESSENTIAL TO EFFECTUATE THE PURPOSES OF THE ACT

The question squarely presented on this appeal is whether the SEC, in an enforcement proceeding, can obtain relief other than the injunctive relief expressly provided in Section 21 (e) of the Act. The Court of Appeals approved the District Court's order requiring Messrs. Holyk, Darke and Clayton to make payments to TGS of $35,663.47, $90,289.50 and $20,101.56,respectively. No provision of the Act authorizes the granting of such an order. Section 21(e), pursuant to which the SEC commenced this action, only provides for injunctive relief.*

* Apparently no other relief was contemplated by Congress. S.Rep.792,73d Cong.,2d Sess., 1934,p.22; H.R.1383,73d Cong.,2d sess., 1934, p.27.

This section reads:

> "Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may bring an action . . . to enjoin such acts or practices . . ."(15 U.S.C.Section 78u(e)(236a).

In justifying payment orders, both Courts relied on the general equity powers conferred upon district courts in Section 27. This Section may authorize a district court to exercise its general equity powers to grant ancillary relief necessary to enforce an injunction which by statute the SEC was empowered to obtain. But nowhere in the legislative history of the Act is there any indication that Congress, in enforcement proceedings, authorized the creation of ancillary remedies unconnected with an injunction. Nor were any decisions in SEC enforcement actions cited to justify this created remedy. The only pertinent case cited to support the District Court's action was Mitchell v. DeMario Jewelry, 361 U.S. 288 (1960).*

*Reliance was also had on United States v. Moore, 340 U.S. 616 (1951) and Porter v. Warner Holding Co., 328 U.S. 395 (1946). Moore concerned Section 206(b) of the Housing and Rent Act of 1947 which was identical to Section 205(e) of the Emergency Price Control Act considered in Porter. In approving an order of

In Mitchell v. DeMario Jewelry, 361 U.S. 288 (1960), this Court approved a payment order, not expressly authorized by statute, on the ground that such order was required to effectuate the purposes of the statute. Mitchell, involved an action by the Secretary of Labor under Section 17 of the Fair Labor Standards Act of 1938, 29 U.S.C. Section 217 (hereinafter "Labor Act"), on behalf of certain employees to recover lost wages. This Court said at pages 292 and 293 that the purpose of the Labor Act was to protect employees by having the Secretary of Labor bring actions on behalf of employees to redress wrongs perpetrated by employers and to recover for the employees lost compensation. If it were otherwise, the Court said, employees would not complain to the Secretary of Labor of violations of the Act for fear of dismissal or economic retribution. Recovery of damages for employees was thus considered as vital to the Secretary of Labor for the effective administration of the Labor Act.

The reasons compelling resort to general equity powers to effectuate the purposes of the Labor Act are not in evidence here. A damage award, while essential to the administration of the Labor Act, is not essential to the SEC's administration of the Act. The Secretary of Labor brings

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Footnote Page 18 - Continued
repayment of rent overcharges, the Moore Court emphasized its reliance on the statutory provision providing for "other orders" in addition to injunctive orders. The Court explained that general equity power can be utilized to fashion the appropriate order once the making of the order itself is authorized by statute.

the action on behalf of the injured employee, while the SEC sues on its own behalf. The Secretary of Labor would not get the cooperation of the employee, on whose behalf he sues, unless he could assure the employee that he would not sustain a financial loss. As is apparent from the litigation involving TGS because of this case, the SEC needs no such cooperation from allegedly injured parties. Lastly, the damages recovered by the Secretary of Labor are paid directly to the injured employee on whose behalf the action was brought. There is no such close connection to the parties purportedly injured by petitioners' acts.

When a court goes beyond a statute to create a remedy the justification should be that the new remedy as in Mitchell, is not only effective but is required to effectuate the purposes of the statute, and not as here, merely because it appears to further the statute's purposes. There is no doubt that restitution of profits is not necessary to achieve the purposes of the Act. Moreover, ordering an employee to pay huge sums made by tippees will probably prove an ineffective bromide. Few, if any employees, will be able to pay the judgments and tippees will be left free to enjoy their gains. This is the type of result which obtains when the SEC and the court join hands to avoid working within the framework of the Act.

IV

THE ORDERING OF PAYMENTS BY PETITIONERS TO TGS CONSTITUTES THE IMPOSITION OF PENALTIES

A court of equity is not empowered to make penalty assessments. Beck v. Securities Exchange Commission, 430 F. 2d 673 (6th Cir. 1970); United States v. Parkinson, 135 F. Supp. 208, aff'd 240 F. 2d 918 (9th Cir. 1956). As the Court said in Parkinson:

> "Anything which savors of a penalty should not be permitted unless Congress has expressly so provided, since the spirit of equity abhors such punitive measures." 240 F. 2d at 922

The payments required to be made here are penalties within the meaning of that term as defined in United States v. Chouteau, 102 U.S. 603, 611 (1880) wherein the Court said:"The term 'penalty' involves the idea of punishment, and its character is not changed by the mode in which it is inflicted. . ." In the instant case the punitive nature of the District Court's judgment is most apparent when we consider the payment Mr. Darke is ordered to make to TGS. A portion of that payment, to wit: $48,404.58 (plus interest from 1964 at 6%)represents profits purportedly made by third parties - money which Darke never received either directly or indirectly. The amount of the payment is staggering. The basis for arriving at it is without precedent.

The Court of Appeals, at least as regards Mr. Darke, impliedly recognized the punitive nature of the payment order by saying, "admittedly more of a hardship is imposed" (229a) on Mr. Darke in connection with paying profits realized by tippees. We submit that this payment order is a good example of a "penalty" as that term was defined by this Court in Chouteau.

V

THE GRANTING OF THE RELIEF HEREIN VIOLATED THE CONSTITUTIONAL RIGHTS OF MESSRS. HOLYK, DARKE AND CLAYTON AND THE DUE PROCESS CONCEPT OF FAIRNESS

The decisions below deprive petitioners of their constitutional rights as contained in the Fifth, Sixth and Seventh Amendments. We submit that procedural requirements of due process are not satisfied when non-prophylactic relief is granted in a prophylactic proceeding. In this prophylactic proceeding only the slightest burden of proof had to be borne by the SEC. (Ans. Brief of SEC Feb. 1967 40-48.) A heavier burden of proof is required for a money award in a civil proceeding and an even heavier burden in a criminal proceeding. If this Court agrees that the payment orders are penalties, then it is the latter burden which should have been borne by the SEC.

If the action were for money damages for violating Section 10(b), petitioners would have been entitled to a jury trial. Richland v. Crandall, 262 F. Supp. 538 (S.D.N.Y.1967). This right they have been effectively denied by the Court's damage award in violation of the Seventh Amendment. Rachal v. Hill, 435 F. 2d 59 (5th Cir. 1970). The nature of the remedy fashioned by the Court is punitive, yet in a criminal proceeding under the Sixth Amendment, petitioners would have been entitled to a trial by jury.

The petitioners' Fifth Amendment rights have also been abridged. That Amendment has been held to require that:

> "***a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed. To make the warning fair, so far as possible, the line should be clear." McBoyle v. United States, 283 U.S.25, 27 (1931) (Holmes, J.).

This Court has also held that an administrative body must frame its rules so "that the ordinary person can know how to avoid an unlawful course of action." M. Kraus & Bros.,Inc. v. United States, 327 U.S. 614, 626 (1946). Rule 10b-5 and its prior interpretations gave no clear warning that the conduct of petitioners herein would be violative of the Act.

VI

THERE IS NO LEGAL BASIS FOR THE ORDER OF RESTITUTION BY MR. DARKE OF PROFITS MADE BY HIS TIPPEES

Under the guise of restitution, Mr. Darke has been ordered to account for profits of $48,404.58 made by three other people. Equitable remedies are elastic but they too have limits beyond which they cannot be stretched. There can be no "restitution" in the absence of receipt or retention of benefits. See, e.g. Greenwood County v. Duke Power Co., 107 F. 2d 484 (4th Cir. 1939); Restatement, Restitution Section 1. There is no record proof that Mr. Darke ever received any benefits from his tippees.

The most that could be found in this case is that Mr. Darke recommended TGS stock at a time when he possessed confidential information. While making a recommendation in such circumstances would apparently constitute, if the decision of the Court of Appeals is sustained, a violation of Rule 10b-5, it is hardly fair to order Mr. Darke, a Canadian citizen, who was not an officer of TGS and who received no benefit from these purchases by others, to pay out of his own pocket the "profits" supposedly made by third persons. This is especially so when it is considered that prior to the institution of this action, no such possible liability had even been predicted.

If Mr. Darke violated the Act in passing confidential information to subsequent purchasers, adequate penal provisions are contained in the Act for penalizing him. Resort to these provisions should be had by the SEC before other provisions of the Act are distorted beyond recognition to achieve the same result.

VII

THE DISTRICT COURT ABUSED ITS DISCRETION IN GRANTING THE INJUNCTION AGAINST PETITIONER CLAYTON

We submit that the District Court abused its discretion in enjoining Mr. Clayton "from engaging in the purchase or sale of Texas Gulf Sulphur Company securities on the basis of undisclosed material information relating to Texas Gulf Sulphur acquired by ... reason of any relationship with Texas Gulf Sulphur Comapny (216a).

Unless a reasonable likelihood of future violations can be shown, injunctive relief should not be granted where the violations sought to be enjoined have ceased. SEC v. Pearson, 426 F. 2d 1339 (10th Cir. 1970) The record is barren of any facts to show that there is a reasonable likelihood that Mr. Clayton may violate the Act.

The facts concerning Mr. Clayton and Mr. Darke are almost identical, yet the Court enjoined one and not the other. As regards Mr. Darke the Court said:

> "In considering the remedy of injunction, it is noted that defendant Darke is a Canadian living in Canada. He is no longer in the employ of TGS, and hence no longer privy to any material inside information with respect to its activities. The material undisclosed information possessed by Darke when he made his purchases and recommended TGS securities to others was disclosed in April, 1964 press release announcing TGS's discovery. The SEC seeks injunctions only with respect to trading in TGS securities on the basis of TGS material undisclosed information. Since Darke no longer has the opportunity, no useful purpose would be served by the issuance of an injunction..." 312 F. Supp. at p. 90.

The same facts obtain as to Mr. Clayton; he is a resident of Canada, no longer employed by TGS, and no longer privy to material inside information. Moreover, there is no showing that he committed any violation of the Act since April 15, 1964.

The District Court, in enjoining Mr. Clayton, and the Court of Appeals, in approving the injunction, appear to have disregarded the "reasonable likelihood" test. Mr. Clayton was enjoined because

he purchased 200 TGS shares with knowledge of the mineral discovery. There was no showing, however, that he knew his purchase violated the Act. This single purchase by Mr. Clayton does not establish that there is a "reasonable likelihood" that he will violate the Act in the future. If he did have a propensity to violate the Act, it certainly should have evidenced itself in the last seven years.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

September 8, 1971

Respectfully submitted,

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Appendix C

Constitutional Provisions, Statutes and Rules Involved

Sixth Amendment to the Constitution of the United States

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining Witnesses in his favor, and to have the Assistance of Counsel for his defense.

Seventh Amendment to the Constitution of the United States

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

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In the Supreme Court of the United States

OCTOBER TERM, 1971

Nos. 71-327, -328, -346, -347

TEXAS GULF SULPHUR COMPANY, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

EARL L. HUNTINGTON, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

DAVID M. CRAWFORD, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

WALTER HOLYK, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 220a-233a) is reported at 446 F. 2d 1301. The opinion

of the district court (Pet. App. 175a–214a)[1] is reported at 312 F. 2d 77. The prior opinions of the court of appeals (Pet. App. 66a–171a) and the district court (Pet. App. 1a–63a) are reported respectively at 401 F. 2d 833 and 258 F. Supp. 262.

JURISDICTION

The judgment of the court of appeals was entered on June 10, 1971 (Pet. App. 220a).[2] The petitions for writs of certiorari were filed on September 3, 1971, and September 8, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). Because petitioners' notice of appeal to the court of appeals may have been a nullity (see n. 3 *infra*), there may be a question as to the jurisdiction of this Court.

QUESTIONS PRESENTED

1. Whether Rule 10b–5 of the Securities and Exchange Commission, which proscribes activities operating as a fraud or deceit upon any person in connection with the purchase or sale of securities, validly outlaws

(a) the issuance without due care of a materially misleading corporate press release reasonably calculated to influence the investing public;

(b) trading by insiders in securities of their corporation on the basis of undisclosed material facts and

[1] "Pet. App." refers to petitioners' appendix in No. 71–327.

[2] The prior judgment of the court of appeals was entered on August 13, 1968. Petitioners filed a petition for rehearing on September 20, 1968, which was denied on October 7, 1968. Separate petitions for certiorari were filed by Harold B. Kline, who once again seeks review in No. 71–327, and by Francis G. Coates. Both petitions were denied. 394 U.S. 976.

the giving of tips for others to trade on the basis of such facts; and

(c) the acceptance by top corporate officials of stock options without disclosing to the corporate directors granting such options material nonpublic information affecting the market value of the corporation's stock.

2. Whether a press release issued by petitioner Texas Gulf Sulphur Company to deny newspaper stories respecting a rumored ore discovery by Texas Gulf was materially misleading and issued without due care.

3. Whether information respecting Texas Gulf's drilling into what proved to be a remarkably rich deposit of copper, zinc, and silver ore was material information that should have been disclosed when insiders of the company purchased its stock, gave tips or accepted stock options.

4. Whether the court of appeals properly held that the district court did not abuse its discretion in enjoining the commission of future similar violations by certain insiders of Texas Gulf who had purchased its stock "knowing beyond peradventure of a doubt that [Texas Gulf] had made a very important mineral discovery" that had not been disclosed.

5. Whether Section 27 of the Securities Exchange Act, granting the district court jurisdiction over violations of the Act and over all suits in equity to enforce any liability or duty created by the Act, authorized the district court, in an injunction action brought by the Commission, to direct that the profits resulting from violations of the Act be given up, both

by violators who are enjoined and by those who are not enjoined.

6. Whether a court of appeals can decide a case *en banc* when only a three-judge panel has heard oral argument and, if not, whether the precedure can be attacked by parties who failed to object when the court announced that it intended to follow such procedure.

STATUTE AND RULE INVOLVED

Sections 10(b), 21(e) and 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78u(e) and 78aa, and Rule 10b–5 of the Commission, 17 CFR 240.10b–5, are set out at Pet. App. 235a–239a.

STATEMENT

This action arises out of "a major strike of zinc, copper and silver * * *" (Pet. App. 40a) by Texas Gulf Sulphur Company ("Texas Gulf") on land located near Timmins, Ontario, Canada. The exploratory drilling that preceded a news release distributed at a press conference announcing this discovery on April 16, 1964, was carried out by Texas Gulf in the preceding five-month period (Pet. App. 1a). The courts below found that, prior to sufficient dissemination of this announcement to the public, ten officers, directors and employees of Texas Gulf, who possessed various degrees of information about the results of the drilling at various stages in the exploration, all engaged in securities transactions in violation of Section

10(b) of the Securities Exchange Act and the Commission's Rule 10b–5.

The court of appeals affirmed the judgment entered April 16, 1970, against six of the nine individual petitioners: Harold B. Kline, vice president and general counsel; David M. Crawford, secretary; Walter Holyk, chief geologist; Earl L. Huntington, attorney; Richard Clayton, engineer, and Kenneth H. Darke, geologist; no judgment was entered against petitioners Claude O. Stephens, president and director, Charles F. Fogarty, executive vice president and director, or Richard D. Mollison, vice president-exploration.[3] The court

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[3] One of the defendants, Francis G. Coates, a director of Texas Gulf, consented to entry of a judgment against him on October 2, 1969, pursuant to a stipulation with the Commission (R. 6412–6420).

On June 22, 1970, a default judgment was entered against another defendant, Thomas P. O'Neill, an accountant who had been employed by Texas Gulf. Petitioners' notice of appeal, which was filed on June 15, 1970, preceded the entry of the default judgment. Since there had not been, as Rule 54(b) of the Federal Rules of Civil Procedure specifies, an "express determination that there [was] no just reason for delay" and there had been no "express direction for the entry of judgment," the order petitioners appealed from, entered on April 16, 1970, appears not to have been a final judgment that is appealable. *Davis* v. *National Mortgage Corp.*, 320 F. 2d 90 (C.A. 2); *G.W.K., Inc.*, v. *Philco Corp.*, 276 F. 2d 928 (C.A. 2); *Partin* v. *Hassan Motors, Inc.*, 363 F. 2d 104 (C.A. 6). See also *Advisory Committee Notes on Rule 54(b)* (1961 Amendments). A premature notice of appeal has been held to be a nullity and without effect. *Studer* v. *Moore*, 153 F. 2d 902, 903 (C.A. 2); *Stevens* v. *Turner*, 222 F. 2d 352 (C.A. 7); *Aberlin* v. *Zisman*, 244 F. 2d 620 (C.A. 1), certiorari denied, 355 U.S. 857. The Commission, without urging dismissal on this ground, brought these facts and authorities to the attention of the court below, which did not comment thereon.

of appeals also held that petitioner Texas Gulf violated Section 10(b) and Rule 10b–5 by failing to exercise due diligence in issuing a misleading press release on April 12, 1964, denying rumors of a "major strike" only four days before the ore strike was formally announced. No judgment was entered against Texas Gulf.

1. THE COMMISSION'S COMPLAINT

On April 19, 1965, the Commission filed a complaint (JA 77a–115a)[4] in the district court alleging that, during the exploratory drilling and before the information contained in the April 16 press release became available to the public, thirteen officers, directors and employees of Texas Gulf, including petitioners, had each committed one or more of the following violations of Section 10(b) and Rule 10b–5:

> 1. Purchased Texas Gulf common stock or calls on that stock on the basis of the results of the drilling without appropriate disclosure.
>
> 2. Divulged information as to drilling results to friends, relatives or business associates for use in their purchases, without appropriate disclosure, of Texas Gulf stock or calls or recommended on the basis of such inside information that they purchase Texas Gulf securities.
>
> 3. Accepted stock options from Texas Gulf while this information as to drilling results was concealed from Texas Gulf's directors.

It also alleged that Texas Gulf had violated Section 10(b) and Rule 10b–5 by the issuance on April 12,

[4] "JA" refers to the joint appendix in the court of appeals, a copy of which has been lodged in this Court.

1964, of a false and misleading press release about the ore deposit.

The complaint requested that the defendants be permanently enjoined from future similar violations of Section 10(b) and Rule 10b–5; that the individual defendants who had violated those provisions by purchasing Texas Gulf stock or calls be required to offer rescission to the sellers; that those who had divulged such information be required to offer restitution to stockholders who had sold Texas Gulf securities to the recipients of the information; and that stock options accepted by the defendants be rescinded (JA 113–115).

2. THE EVIDENCE RELEVANT TO PETITIONERS

In 1963, Texas Gulf was a narrowly-based company deriving 97 per cent of its income from sulphur (JA 1222a). Because of an over-supply of sulphur on the world market, Texas Gulf's sales and earnings had declined from 1955 to 1963, and Texas Gulf was endeavoring to deal with its depressed business by diversifying into related fields. One aspect of this diversification was an exploratory program for base metal sulphides in Canada.[5] (Pet. App. 2a–5a), which, if successful, would open a new area of corporate opportunity for the company (JA 1060a). Up to November 1963, however, the corporation had spent six years and millions of dollars in exploring more than 15,000 square miles of eastern Canada without success (Pet. App. 5a, 8a; JA 1723a).

[5] Sulphides are chemical combinations of sulphur with other elements (Pet. App. 59a n. 2).

Texas Gulf had an option to purchase the northeast quarter section of a square-mile plot of land located near Timmins, Ontario called the Kidd 55 segment (Pet. App. 6a). It had obtained the option after conducting an aerial geophysical survey, confirmed by subsequent geophysical investigations on the ground, indicating the existence of a wide "first class" anomaly [6] measuring some 1000 feet in length (Pet. App. 6a, 8a, 29a).

On November 8 through 12, 1963, Texas Gulf drilled an exploratory drill hole, K–55–1, on this section (Pet. App. 8a). Although the anomaly could have been caused by worthless materials (Pet. App. 59a n. 3), a visual examination of the core recovered from the hole revealed such high copper and zinc values over a length so great—approximately 600 consecutive feet of the core's 657-foot length (Pet. App. 27a–28a)—that four expert witnesses called by petitioners testified they had never seen or heard of a comparable initial exploratory drill hole in a base metal mineral deposit (Pet. App. 76a). Moreover, the mineralization began only 26 feet below the surface of the earth. This drill hole has been described as "one of the most impressive drill holes completed in modern times" (Pet. App. 90a n. 13) and "just beyond your wildest imagination" (Pet. App. 90a).

The "excited" company geologist, Mr. Darke, who had been at the drill site, called from Timmins to his superior Dr. Holyk at his home in Stamford, Connect-

[6] An anomaly is a deviation from the normal in the earth's crust of such physical characteristics as electrical conductivity (R. 665).

icut, on Sunday evening, November 10, to report the initial intersection of copper mineralization (JA 723a–724a, 260a–261a). Within two days this and subsequent reports from the drill site had brought Dr. Holyk, Mr. Mollison and Dr. Fogarty, senior officials of the corporation, from New York to Timmins under conditions of great personal discomfort. There they were able to compare the visual estimates of the mineralization in the core logged by Messrs. Holyk and Darke with the actual core (JA 719a, 723a–724a, 756a–758a, 848a–850a).

As a result of the information thus obtained by the top management of Texas Gulf, security measures were taken to keep the results of the drilling secret so that the corporation could acquire the remainder of the land at favorable prices (Pet. App. 8a–9a; JA 910a–911a, 245a). These measures included an order by Mr. Stephens, the president of the corporation, that no one outside the exploration group, not even the nonmanagement directors, should be told about the drilling results (Pet. App. 47a, 75a). Drilling was suspended and was not resumed until March 31, 1964 (Pet. App. 9a).

During the four and one-half months between November 12, 1963, when K–55–1 was completed, and March 31, 1964, when the drilling was resumed on the Kidd 55 segment, the individual defendants and certain other persons who received "tips" from them purchased Texas Gulf stock and calls thereon. Prior to these transactions "these persons had owned 1135 shares of TGS stock and possessed no calls; there-

after they owned 8235 shares and possessed 12,300 calls" (Pet. App. 76a).[7]

During this period Texas Gulf granted stock options covering 89,950 shares of Texas Gulf stock to officers and employees of the company, including options covering 30,700 shares to petitioners Stephens, Fogarty, Kline, Mollison and Holyk. Pursuant to the secrecy order of the corporation's president (see p. 9, *supra*), who had recommended the granting of the options, the news of Texas Gulf's discovery of copper and zinc in Timmins had been withheld from the members of the incentive stock option committee of the board of directors (JA 329a–330a, 332a–333a, 339a–341a, 362a), which met on February 20, 1964, and recommended the granting of the options (Pet. App. 46a). After the meeting of the committee there was a meeting of the full board, at which time the recommended options were formally granted (Pet. App. 46a). None of the nonmanagement directors knew about the drilling results (Pet. App. 63a n. 16). Mr. Kline, as administrative vice president and secretary, attended both the meeting of the committee and the meeting of the full board (Pet. App. 103a; JA 401a–402a). Although the options were intended to be granted at the fair market value of the underlying stock based upon its current market price (Pet. App. 48a), neither Stephens, Fogarty nor Kline informed the committee or board about the drilling results.

Drilling on the Kidd segment was resumed by Texas Gulf on March 31, 1964, and by Friday, April 10, 1964,

[7] Individual purchases are set forth in chronological order at Pet. App. 70a–71a.

"approximately ⅔ of the ore ultimately found to exist by the time of the preparation of the April 16, 'major strike' release had been discovered by 5 holes placed so as to indicate continuity of mineralization within the large anomaly" (Pet. App. 114a n. 28). By 7:00 a.m. on Monday, April 13, 1964, when Texas Gulf's "gloomy" press release appeared in New York City newspapers (Pet. App. 58a), all but one of the seven holes upon which Texas Gulf based its April 16 announcement that it had made a "major strike" had either been completed or had already encountered mineralization (Pet. App. 8a–12a).[8]

The "gloomy" press release was "designed to quell the rumors" reported in New York newspapers on Saturday, April 11, 1964, respecting the ore discovery by Texas Gulf (Pet. App. 78a). On that day Dr. Fogarty conferred with Mr. Mollison, who had left Timmins the preceding day and returned to his home in Connecticut, and who advised Dr. Fogarty of the drilling results as of 7:00 p.m. April 10 (Pet. App. 53a). On Sunday, April 12, 1964, after the release had been drafted for Monday morning publication, Dr. Fogarty again called Mr. Mollison to see if he had any further information and was told that he did not (Pet. App. 54a). Despite the rapidly developing situation at Timmins (Pet. App. 10a–11a, 59a n. 4), the draftsmen of the release made no effort to determine what had happened at the drill site between Friday evening and

[8] The mineralization encountered by these six holes as of that time amounted to 90 percent of the mineralization announced in the April 16 press release (Pet. App. 114a n. 28).

Sunday afternoon.[9] Dr. Fogarty, the principal draftsman of the release, admitted that he did not want "to take that trouble" to obtain such information (J.A. 863a).

Notwithstanding the fact that none of the "drilling results after 7:00 p.m. on April 10 were known to the framers of the April 12 release" (Pet. App. 57a), the release (Pet. App. 177a–178a), which was issued Sunday afternoon and designed to appear in Monday's papers, spoke in terms of "[t]he drilling done to date" and "work done to date." It labeled the rumors of an ore discovery as "exaggerate[d]" and "without factual basis"; it indicated that any statements about size and grade of ore were "premature and possibly misleading"; it labeled the Kidd 55 segment a "prospect" and indicated that "more drilling would be required for proper evaluation * * *." The release did not give any facts concerning the amount of drilling done nor the results of such drilling.

Stories reflecting the release appeared in the *Wall Street Journal* and other news media on Monday, April 13, 1964, as well as on the Dow Jones broad tape (Pet. App. 188a).[10] The price of Texas Gulf common

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[9] There were no problems with respect to telephone communication between New York and Timmins (JA 774a), and both Messrs. Darke and Clayton were in Timmins on April 12 (Pet. App. 37a; JA 731a).

[10] On the morning of April 13, the day the press release was disseminated to the investing public, Mr. Ackerley, a reporter for *The Northern Miner*, visited the drill site, where Messrs. Mollison, Holyk and Darke were present. Based entirely on the information obtained that morning (Pet. App. 56a; JA 833a–834a), Mr. Ackerley wrote an article that appeared in *The*

stock on the New York Stock Exchange, which had shown a steady rise from $16 a share in November 1963 to $32 a share when it opened on the Exchange on April 13, 1964, closed at 30⅞, and continued to decline in price on April 14 and 15 (Pet. App. 83a).

On the afternoon of April 15, the top management of Texas Gulf decided to hold a press conference the next morning, following a regularly scheduled meeting of the board of directors, to announce the discovery (JA 867a–868a).[11] This method of announcing the major ore discovery was chosen "to get the information to the most stockholders as quickly as it was possible," and because the board considered a press conference to be "the best media [sic] to get maximum coverage to everyone at the same time." (JA 869a–870a). Following the news of the discovery, on substantially increased trading, the price of Texas Gulf common stock on the Exchange closed on April 16, 1964, at 36⅜, seven points over its close of the previous day. By mid-May the stock was trading at more than $58 a share (Pet. App. 83a).

During the period of drilling activity from March 31, 1964, to April 16, 1964, defendants purchased an additional 1860 shares of Texas Gulf stock (Pet. App. 70a). Among these purchases were those made by Messrs. Crawford and Clayton "within 24

Northern Miner on April 16, 1964, which stated that "a major new zinc-copper-silver mine is definitely in the making * * *" and mentioned an indicated ore reserve of more than 10 million tons (Pet. App. 82a, 34a–35a).

[11] This was the first time in at least 14 years that a Texas Gulf directors' meeting was to be followed by a press conference (JA 869a, 847a).

hours before the news of the ore strike was made public" on April 16 (Pet. App. 225a). At the time of their purchases both were aware of the April 12 press release (Pet. App. 39a, 101a) and both knew "beyond peradventure of a doubt" that Texas Gulf "had made a very important mineral discovery" (Pet. App. 197a).

3. THE JUDICIAL DECISIONS

A. THE INITIAL DECISIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS: THE VIOLATIONS [12]

The district court and all the judges of the court of appeals sitting *en banc* agreed that Section 10(b) and Rule 10b–5 prohibit corporate insiders from purchasing their corporation's securities or calls thereon on a national securities exchange when the purchases are made on the basis of material information about the corporation which is not available to the investing public (Pet. App. 20a–24a, 73a–74a, 119a, 128a, 170a). They also agreed that any member of top management who accepted a stock option from a corporation while withholding material information from the directors would also violate Section 10(b) and Rule 10b–5 (Pet. App. 48a–49a, 73a, 119a–121a, 128a, 146a–147a).[13] Furthermore, they agreed that in enforcement actions

[12] Pursuant to a stipulation by all parties the question of the appropriate remedy was deferred pending the initial appeal; therefore the first round of decisions by the district court and the court of appeals dealt with the question whether violations of the Securities Exchange Act had occurred.

[13] Both courts apparently recognized that in granting incentive stock options the directors of the company necessarily rely on information furnished to them by the top management of the corporation (Pet. App. 47a), and that the latter are there-

under Section 10(b) and Rule 10b–5 the Commission need not prove scienter or intent to deceive (Pet. App. 18a–20a, 99a–100a, 119a, 128a, 170a).

INSIDERS PURCHASING TEXAS GULF STOCK AND "TIPPING" OTHERS TO PURCHASE

The district court held that the persons who had purchased stock or calls or had recommended purchase of Texas Gulf stock to others prior to 7:00 p.m. on April 9, 1964, when the court found that there was "real evidence that a body of commercially mineable ore might exist" (Pet. App. 28a–29a), did not violate Rule 10b–5 because in its view the drilling results had not been material up to that time (Pet. App. 33a–34a). While the district judge found that "[t]here was no doubt that the [first] drill core * * * was unusually good and that it excited the interest and speculation of those who knew about it" (Pet. App. 29a), he believed that "* * * the test of materiality must necessarily be a conservative one * * *" and that only long-term, conservative investors were protected against misuse of inside information (Pet. App. 25a–26a). Only Messrs. Clayton and Crawford, who had purchased or placed orders to purchase Texas Gulf securities just prior to the April 16 announcement of a "major strike", were found to have violated Section 10(b) and Rule 10b–5.

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fore "under a duty to inform * * * [them] of material information affecting the issuance of the stock options," including "material information bearing on the market value of * * * [the] stock on that date" (Pet. App. 48a). There were, however, some differences of opinion as to when disclosure would be appropriate (Pet. App. 103a n. 24, 119a–121a, 146a–147a).

The court of appeals, while relying on the trial court's "findings of basic fact" (Pet. App. 89a), rejected that court's "conservative" (Pet. App. 87a–88a) standard of materiality. In determining whether the facts involved here were material, it noted two alternative phrasings of the standard of materiality applicable in Rule 10b–5 cases: "'* * * whether a *reasonable* man would attach importance * * * [to the information] in determining his choice of action in the transaction in question,'" and whether "'* * * in reasonable and objective contemplation [the information] *might* affect the value of the corporation's stock or securities * * *'" (Pet. App. 87a, emphasis in original). It held that all investors, including those with speculative objectives, are entitled to the protection of the Act (Pet. App. 88a), and it ruled that the information about the first drill core was material, since it "might well have affected the price of TGS stock and would certainly have been an important fact to a reasonable, if speculative, investor in deciding whether he should buy, sell, or hold" (Pet. App. 89a).[14]

[14] The court criticized the trial court for disregarding "the only truly objective evidence of the materiality of the K–55–1 discovery"—"the importance attached to the drilling results by those who knew about it" and their "insider trading activity" (Pet. App. 91a). It concluded that "the timing by those who knew of it of their stock purchases and their purchases of *short-term* calls—purchases in some cases by individuals who had never before purchased calls or even TGS stock—virtually compels the inference that the insiders were influenced by the drilling results." The trial court had "made no finding that the insiders were motivated by any factor other than the extraordinary K–55–1 discovery when they bought their stock and their

Accordingly, the court of appeals reversed the district court, holding that those insiders who had purchased Texas Gulf stock or calls thereon, or who had "tipped" others to purchase Texas Gulf stock [15] after November 12, 1963, were in possession of material inside information and therefore, having failed to disclose that information, were in violation of Section 10(b) and Rule 10b-5 (Pet. App. 73a–74a). The court remanded the case to the district court to determine the appropriate remedy (*ibid.*). At the same time the court unanimously affirmed the district court's judgment with respect to Messrs. Crawford and Clayton, who had purchased Texas Gulf stock just prior to the April 16 release (Pet. App. 73a, 170a).

INSIDERS' ACCEPTANCE OF STOCK OPTIONS

With respect to those who received stock options, the district judge found no violations because he viewed the drilling results as not material by February 20, 1964, the date on which the options were granted (Pet.

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calls" but had relied "upon what these defense experts said the defendant insiders *ought* to have thought about the worth to TGS of the K–55–1 discovery." *Id.*

For example, Dr. Fogarty, who owned 705 shares of Texas Gulf stock before this period of time (JA 235a), purchased 300 shares of Texas Gulf stock on November 12, 1963, just before he left for Timmins to view the "remarkable" core for himself. (Pet. App. 13a; JA 850a). Following his return, he purchased 700 shares of Texas Gulf stock on November 15, 1963, and 500 shares on November 19, 1963 (Pet. App. 13a). On November 26, 1963, he purchased another 200 shares (Pet. App. 13a).

[15] All nine judges of the court of appeals appeared to agree that the practice of tipping is unlawful, although they differed as to the scope of the prohibition (Pet. App. 86a, 94a n. 16, 170a).

App. 49a). In addition, the court determined that Messrs. Kline, Mollison and Holyk were not members of top management and had no duty to inform the directors of information known by their superiors "since they could assume that such information would be reported" to them by Stephens and Fogarty, the company's top two officials (Pet. App. 48a).

The court of appeals reversed the district court with respect to Messrs. Stephens, Fogarty and Kline, holding that they violated Section 10(b) and Rule 10b-5 because they were in possession of material information when they accepted their stock options, and remanded the case for a determination of the appropriate remedy (Pet. App. 118a). In addition, with respect to Mr. Kline it decided that he was a member of top management [16] (Pet. App. 103a) and that, although he "had no detailed knowledge of the drilling progress * * *" (Pet. App. 102a), he violated his "duty before accepting his option to disclose any material information he may have possessed * * *" (Pet. App. 103a). Mr. Stephens and Dr. Fogarty had surrendered their options and these had been canceled by the company (Pet. App. 102a). The court of appeals on remand instructed the district court to direct rescission of the option granted to Mr. Kline (Pet. App. 118a).

TEXAS GULF'S APRIL 12, 1964, PRESS RELEASE

The trial court held that the press release was not issued "in connection with the purchase or sale of any

[16] The Commission did not appeal the trial court's determination that Messrs. Mollison and Holyk were not members of top management (Pet. App. 103a–104a).

security" within the meaning of Section 10(b) and Rule 10b–5 because there was no "showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders * * *" (Pet. App. 54a). Alternatively, the court concluded that although the drilling results as of 7:00 p.m. April 9, 1964, were material, the press release, while perhaps "gloomy or incomplete," was not misleading or deceptive "on the basis of the facts then known" to Texas Gulf—the drilling results as of 7:00 p.m. April 10, 1964—(Pet. App. 58a). Moreover, without reference to the failure by the company to secure more up-to-date drilling information, the district court found that Messrs. Stephens and Fogarty had "exercised reasonable business judgment under the circumstances" in issuing the release on "the facts then known" (Pet. App. 58a).

Reversing the district court, the court of appeals held that the "in connection with" requirement in Section 10(b) and the Rule is satisfied when "* * * the device employed * * * be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities" (Pet. App. 109a). It further determined that the Commission, which was "charged by Congress with the responsibility of policing all misleading corporate statements" (Pet. App. 111a), need not show that the corporation or those responsible for the corporate statements "engaged in related securities transactions or otherwise acted with wrongful motives" (Pet. App. 109a). To read such a

requirement into the statute it concluded would "render the Congressional purposes ineffective" and "handicap unreasonably the Commission in its work" (Pet. App. 111a). Accordingly, it held (Pet. App. 113a) that

> * * * Rule 10b–5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media * * * if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes. * * *

In determining "whether the release was misleading, *i.e.*, whether it conveyed to the public a false impression of the drilling situation at the time of its issuance," the court rejected the district court's test that Texas Gulf was to "be judged *on the facts known to them* when the April 12 release was issued" (Pet. App. 113a, emphasis in original.) The "primary inquiry," in the view of the court of appeals, was "the meaning of the statement to the reasonable investor and its relationship to truth" (Pet. App. 114a).

While several of the court of appeals judges thought that the evidence established as a matter of law that Texas Gulf's April 12, 1964, press release was misleading and that its issuance violated Section 10(b) and Rule 10b–5 (Pet. App. 129a, 121a–122a, 128a), four judges were of the view that they could not "definitively conclude" from the record that it was deceptive or misleading to the reasonable investor (Pet. App. 115a). Accordingly, the district court was di-

rected to determine on remand "the character of the release in light of the facts existing at the time of the release, by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it" (*ibid.*). If so, the district court was to determine not whether Texas Gulf had "exercised 'reasonable *business* judgment under the circumstances'" but whether "the misleading statement resulted from a lack of due diligence on the part of" Texas Gulf (Pet. App. 116a, emphasis in original).

B. The Subsequent Decisions of the District Court and the Court of Appeals: The Appropriate Remedy.

THE INDIVIDUAL DEFENDANTS

On remand, following an evidentiary hearing, the trial court denied all relief against Messrs. Fogarty, Mollison and Stephens, finding that they had surrendered to Texas Gulf at their cost and without profit the stock or stock options they had acquired in violation of Rule 10b–5. The court found that the wide publicity accorded these defendants would serve as an adequate deterrent to future violations (Pet. App. 196a, 211a–212a), for which reason the trial court also refused to enjoin most of the other defendants (Pet. App. 196a–197a). The court issued injunctions, however, against Messrs. Crawford and Clayton, whose violations of Section 10(b) and Rule 10b–5 the court of appeals *en banc* had unanimously upheld (*supra*, p. 17), and who had "* * * purchased during the period of nondisclosure knowing beyond peradventure

of a doubt that TGS had made a very important mineral discovery" (Pet. App. 197a).

Pursuant to the Commission's request for relief other than injunctive, the district court also directed that defendants Darke, Holyk, Huntington and Clayton be deprived of the profits from their purchases of Texas Gulf stock or of calls on Texas Gulf stock on the basis of inside information, and that these profits be paid over to Texas Gulf to be held in escrow (Pet. App. 197a–210a). The court concluded that to do so was in accord with the congressional purpose to "protect the investing public by deterring possible future violations of Section 10(b) and Rule 10b–5" (Pet. App. 203a). Pursuant to the appellate court's instructions to determine the appropriate remedy for defendant Darke's "tipping" of other investors (Pet. App. 74a), the district court distinguished between "those who purchased TGS securities on Darke's recommendation and those who purchased on the recommendation of one of Darke's 'tippees' " and concluded that it would be a "sufficient deterrent" to direct Darke to pay Texas Gulf to hold in escrow "the profits realized by the 'tippees' who purchased on Darke's recommendation * * *" (Pet. App. 206a–207a).

With respect to Mr. Kline, the court refused to enjoin him from violating Section 10(b) and Rule 10b–5 by accepting Texas Gulf stock options while possessing material inside information (Pet. App. 213a). Pursuant to the mandate of the court of appeals, however, it entered judgment against him and directed

that he return his option to Texas Gulf to be cancelled (Pet. App. 212a–213a).

The court of appeals affirmed the judgment of the district court as to the individual defendants except with respect to Mr. Kline.[17] As to the remedy, the court affirmed the Commission's authority, pursuant to Section 21(e) to seek restitution, and an equity court's power, pursuant to Section 27, to grant that remedy as ancillary relief (Pet. App. 226a–230a).

TEXAS GULF'S APRIL 12, 1964, PRESS RELEASE

As to Texas Gulf, the district court, after reviewing the testimony of investor witnesses who had seen reports of the April 12 release in the news media,[18] held

[17] The court reversed the judgment ordering cancellation of Mr. Kline's option and, in effect, confessed error, noting that its prior "unambiguous instruction" ordering cancellation after the parties had specifically deferred the question of remedy deprived Mr. Kline of his day in court on that question (Pet. App. 230a). The case was remanded to the trial court (Pet. App. 231a), where on August 11, 1971, a hearing was held. On September 1, 1971, the trial court, in a memorandum opinion determined that, rather than cancelling his option, Mr. Kline should be deprived of any illegal profits obtained from the exercise of his option. *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, CCH Fed. Sec. L. Rep. ¶ 93,211 (S.D. N.Y., 1971). Judgment was entered on October 4, 1971.

[18] Texas Gulf asserted that it could only be held responsible for "the press release itself, not for the inaccurate or incomplete' version carried by the news media" (Pet. App. 188a). However the court rejected this argument stating:

"By issuing the press release 'For Immediate Release,' TGS was depending on the news media to report it to its shareholders. They could not have expected the news media to publish the entire press release, but only those portions which the media deemed important." (Pet. App. 189a). [continued]

"[o]n the basis of the standards laid down by the Court of Appeals," that the press release was "misleading to the reasonable investor using due care" and that "the framers did not exercise due diligence in its issuance" (Pet. App. 188a); therefore, the court ruled that Texas Gulf had violated Section 10(b) and Rule 10b–5. It noted, however, that there was no evidence of any other misleading press releases issued by the company in almost five years since the Timmins discovery, which the court termed a " 'once-in-a-lifetime affair' "; accordingly, it held that there was "no 'proper showing' " of any reasonable likelihood of future violations (Pet. App. 192a), and did not issue an injunction against the company.

The court of appeals held that the finding that Texas Gulf violated Rule 10b–5 "is well-founded and, in our view, unassailable" (Pet. App. 225a). The court concluded that the trial court did not abuse its discretion by allowing the admission of non-expert opinion testimony from investor witnesses, on the ground that their testimony was relevant to "[t]he ultimate issue [of] whether the release was 'misleading to the reasonable investor' " (Pet. App. 222a–223a). It also rejected Texas Gulf's claim that the finding of a violation of Rule 10b–5 for mere negligence in issuing the press

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Moreover, it pointed out:

"the fact that the news media emphasized the words which have been found to be misleading to the reasonable investor merely indicates that the news media also deemed them of importance. The failure of the broad tape to mention that a later statement would be issued indicates only that Dow Jones considered it relatively unimportant." (*Ibid.*)

release infringes its First Amendment rights, holding that Texas Gulf's April 12 report on its drilling progress was "commercial 'factual' speech" and, like other reports submitted by companies under the federal securities laws, was not within the protection afforded by the First Amendment (Pet. App. 224a–225a).

ARGUMENT

The courts below correctly rejected petitioners' narrow reading of Section 10(b) of the Securities Exchange Act and Rule 10b–5, both with respect to the scope of the activities covered and to the commission's remedies available in the event of violation. The court of appeals' holdings on these issues are not in conflict with decisions of other courts of appeals. Nor have petitioners raised any constitutional issues worthy of review. Indeed, although this case resolved several important questions, especially with respect to the use of inside information by corporate officials and a corporation's responsibility for the issuance of its press releases, the results reached by the court of appeals follow logically from the development of the federal securities laws in this area.[19]

More than six years have elapsed since the filing of the Commission's complaint, and more than three

[19] See Jennings, *Insider Trading in Corporate Securities: A Survey of the Hazards and Disclosure Obligations under Rule 10b–5*, 62 Nw. U. L. Rev. 809 (1968); Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 Va. L. Rev. 1271 (1965): *Curent Policy Issues Involving Inside Information in the Securities Markets*, reprinted in 2 Securities L. Rev. 84 (1970).

years since the initial court of appeals opinion, yet none of the concerns expressed by the corporate and financial communities when the complaint was filed have been realized. There is no evidence, for example, that corporate announcements have been curtailed to the injury of the investing public or that competent corporate officials have left their employment for want of adequate forms of remuneration. Indeed, in general it appears that the business community has adapted its standards of conduct to conform with the principles set forth by the courts below without significant difficulty.[20] Petitioners appear to be more concerned with potential liability arising from private civil damage actions than with any alleged inconvenience to the corporate community; private civil actions, however, raise questions substantially different from those raised in Commission enforcement proceedings, which are brought in the public interest. There is no reason for the Court to address itself to those problems here.

1. We note at the outset that no judgment has been entered against petitioners Texas Gulf, Stephens, Fogarty or Mollison, nor do they contend that the findings[21] of which they complain have any effect in

[20] See *e.g.*, *New York Stock Exchange Company Manual* A-18—A-27 (1968); *American Stock Exchange Company Guide* § 401–406 (1970); see also West, *Timely Disclosure—The View from 11 Wall Street*, 24 Sw. L. J. 241 (1970); see generally, Bromberg, *Disclosure Programs for Publicly Held Companies—a Practical Guide*, 1970 Duke L. J. 1139.

[21] The recitals in the judgment cannot be characterized as a judgment against these petitioners. Cf. *Electrical Fittings Corp.* v. *Thomas & Betts Co.*, 307 U.S. 241, 242.

other actions against them. In these circumstances a party is not normally entitled to review of findings with which he does not agree, unless those findings would constitute *res judicata* or serve as the basis for collateral estoppel. See, *e.g.*, *New York Telephone Company* v. *Maltbie*, 291 U.S. 645; *Partmar Corp.* v. *Paramount Pictures Theatre Corp.*, 347 U.S. 89, 99 n. 6.[22] As to petitioner Kline, the order from which he seeks review remanded his case to the district court for a determination of the appropriate remedy. Judgment was subsequently entered against him on October 4, 1971,[23] but no appeal from that judgment has as yet been taken. The posture of his case is, therefore, comparable to its posture at the time this Court denied his earlier petition. 394 U.S. 976.

2. Petitioners contend (TG Pet. 21, 34–35) that the Commission, in an enforcement action brought

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[22] Subsequent cases have not held these findings to be *res judicata* or to have a collateral estoppel effect. See *Fink* v. *Coates*, 323 F. Supp. 988 (S.D N.Y.), and *Cannon* v. *Texas Gulf Sulphur Co.*, 323 F. Supp. 990 (S.D. N.Y.); see also *Rachal* v. *Hill*, 435 F. 2d 59 (C.A. 5), certiorari denied, 403 U.S. 904. But Cf. *Sullivan* v. *Committee on Admissions and Grievances*, 395 F. 2d 594 (C.A. D.C.).

[23] The district court stated in its opinion on remand:

"Mr. Kline took the stand to stress the borderline nature of his violation and was vigorously cross-examined by the Commission. On the evidence, this Court cannot conclude that Mr. Kline knew less about the discovery than what the Court of Appeals found was sufficient basis for a violation of the Act and of the Rule. Indeed, in view of his trip to Utah with Mr. Fogarty a few days after November 12, 1963 and his responsibilities as General Counsel, it may be that he knew more about the initial drill hole than he originally testified to at the trial." *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, *supra*, CCH Fed. Sec. L. Rep. ¶93,211 at 91,350.

in the public interest, must prove all the elements of an ordinary damage suit, including scienter, intent to deceive, reliance, and consequent damages. This Court has noted, however, in *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193, 200, involving an enforcement proceeding under the analogous antifraud provision of the Investment Advisers Act of 1940, 15 U.S.C. 80b–6, that "[i]t is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages" and that "[t]o impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute."

Indeed, petitioners' restrictive construction of Section 10(b) of the Securities Exchange Act conflicts with the principle that "securities legislation 'enacted for the purpose of avoiding frauds' " is to be construed "flexibly to effectuate its remedial purposes," without regard to technical and restrictive notions of intent. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195; see also, *Tcherepnin* v. *Knight*, 389 U.S. 332, 336; cf. *Ellis* v. *United States,* 206 U.S. 246, 257. In passing the Act, Congress recognized that "[s]peculation, maniulation, * * * investors' ignorance, and disregard of trust relationships by those whom the law should regard as fiduciaries" were "all a single seamless web * * *" H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 6

(1934). As this Court has recently observed with respect to the quoted congressional language:

> Since practices "constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers" in the regulatory agency "have been found practically essential." Id., at 7. Hence * * * Section 10(b) must be read flexibly, not technically and restrictively. Since there was a "sale" of a security and since fraud was used "in connection with" it, there is redress under § 10(b), whatever might be available as a remedy under state law.[24] [Superintendent of Insurance of New York v. Banker's Life and Casualty, No. 70–60, decided Nov. 8, 1971, slip op., pp. 5–6.]

The decision of the court below, in recognizing that the scope of Section 10(b) was intended to be as broad as the Act itself (Pet. App. 92a–93a; 105a–113a), serving as a "catchall" to fill gaps left by more specific provisions,[25] is in accord with the decisions of this Court and other courts of appeals.[26]

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[24] See also, 78 Cong. Rec. 7696 (1934) (Remarks of Rep. Rayburn). The Senate Committee viewed the Securities Act of 1933 and the Securities Exchange Act of 1934 as vesting "in the Securities and Exchange Commission jurisdiction over the source of and traffic in securities." S. Rep. No. 1455, 73d Cong., 2d Sess. 393 (1934).

[25] *Hearings before House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720*, 73d Cong., 2d Sess. 115 (1934); see also H. Rep. No. 1383, 73d Cong., 2d Sess. 6–7 (1934), and S. Rep. No. 792, 73d Cong., 2d Sess. 5–6 (1934).

[26] See *Herpich* v. *Wallace*, 430 F. 2d 792, 806 (C.A. 5); *Rekant* v. *Desser*, 425 F. 2d 872 (C.A. 5); *Kahan* v. *Rosenstiel*, 424 F. 2d 161, 172 (C.A. 3), certiorari denied *sub nom. Glen Alden Corp.* v. *Kahan*, 398 U.S. 950; *Matheson* v. *Armbrust*, 284 F. 2d 670, 674 (C.A. 9). See also *Heit* v. *Weitzen*, 402 F. 2d 909 (C.A. 2), certiorari denied, 395 U.S. 903.

3. The courts below correctly held that the April 12 press release, which was issued to counteract the market effect of newspaper reports (J.A. 853a, 854a, 863a, 866a–867a, 939a), was issued "in connection with" the purchase and sale of securities (Pet. App. 105a–113a). The "in connection with" clause in Section 10(b) has been described as "plainly and—one must assume—intentionally the loosest linkage, in any of the federal antifraud provisions, between a proscribed act and a security transaction."[27] Cf. *Superintendent of Insurance of New York* v. *Bankers Life and Casualty, supra.* As noted by the court below, comparison with the other antifraud provisions in the federal securities laws makes clear "that when Congress intended that there be a participation in a securities transaction as a prerequisite of a violation, it knew how to make that intention clear" (Pet. App. 109a). The Second Circuit's construction of this phrase[28] is consistent with that of other courts.[29]

[27] Bromberg, *Securities Law: Fraud-SEC Rule 10b–5*, § 7.6(1) at 190.21.

[28] See also *Securities and Exchange Commission* v. *Great American Industries, Inc.*, 407 F. 2d 453 (*en banc*), certiorari denied, 395 U.S. 920; *Heit* v. *Weitzen, supra*, 402 F. 2d 909. But see, *Superintendent of Insurance of New York* v. *Bankers Life and Casualty*, 430 F. 2d 355 (C.A. 2), reversed this Term, No. 70–60, November 1, 1971.

[29] See, *e.g.*, *Herpich* v. *Wallace, supra*, 430 F. 2d 792; *Kahan* v. *Rosenstiel, supra*, 424 F. 2d at 172; *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Freed* v. *Szabo Food Service, Inc.*, CCH Fed. Sec. L. Rep. ¶91,317 (N.D. Ill.); *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215 (S.D. N.Y.); *Meisel* v. *North Jersey Trust Co.*, 218 F. Supp. 274, 279 (S.D. N.Y.).

The fact that Congress specifically provided for the filing of periodic and other specified reports with the Commission [30] does not imply, as Texas Gulf suggests (TG Pet. 24), that Congress intended that other corporate reports and annoucements be unregulated. One of the basic purposes of the Act was "to insure the maintenance of fair and honest markets" in securities transactions,[31] and as the House Report on the bill stated, "There cannot be honest markets without honest publicity. * * *" [32] Furthermore, the decision below does not, as petitioner Texas Gulf implies (TG Pet. 25), require directors to guarantee the accuracy of every statement which the company makes. The decision requires merely that persons preparing a press release which will affect the market for their corporation's securities use "due diligence" in reporting the facts.

Texas Gulf complains (TG Pet. 26) that the court of appeals' standard [33] for judging the press release—

[30] See Sections 13 and 15(d) of the Act, 15 U.S.C. 78m, 78o(d). The Commission has established a detailed reporting system under these provisions. See Rules 13a–1 to 13b–1, 15d–1 to 15d–21, 17 CFR 240.13a–1 to 240.13b–1, 240.15d–1 to 240.15d–21. It is, of course, implicit in the reporting requirements that the documents filed with the Commission must be complete and accurate.

[31] Section 2 of the Act, 15 U.S.C. 78b.

[32] H. Rep. No. 1383, 73d Cong., 2d Sess. 11 (1934).

[33] In assuming that the court of appeals' standard is based on "the subjective reactions of persons in the market" (TG Pet. 26), petitioners fail to distinguish between the opinion testimony of investor-witnesses, which was relevant to the ultimate issue, and the ultimate issue itself, *i.e.*, whether the re-

"whether the reasonable investor, in the exercise of due care, would have been misled by it" (Pet. App. 115a)—is excessively subjective. In fact, this standard is no more subjective than the reasonable man standard uniformly employed in tort law. See Prosser, *Torts*, 153–168 (Hornbook ed., 1964). Furthermore, the court correctly determined that Texas Gulf's conduct should be judged "in the light of the facts existing at the time of the release" (Pet. App. 115a), and that a finding of violation required also the determination that, in light of these facts, the draftsmen failed to exercise "due diligence" (Pet. App. 116a). The district court's initial finding that "on the basis of the facts known to its draftsmen at the time of its preparation" the press release was an exercise of "reasonable business judgment" (Pet. App. 116a) cannot be equated with a finding of "due diligence" under the court of appeals' test, as Texas Gulf asserts (TG Pet. 26–27). The district court recognized this distinction in finding on remand that "on the basis of the standards laid down by the Court of Appeals * * * the framers of the press release failed to exercise due diligence" (Pet. App. 188a).

4. The court of appeals applied two alternative phrasings of the standard of materiality applicable in Rule 10b–5 cases: that the information is important

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lease was misleading to the reasonable investor (Pet. App. 222a). The Commission offered testimony of investor witnesses solely to buttress its contention that the release on its face was misleading.

to a "reasonable" investor and that "in reasonable and objective contemplation" it might affect the market price of the stock (see p. 16, *supra*).[34] Other courts of appeals have adopted both of these standards.[35] Of

[34] Petitioners argue that the court of appeals correctly stated that a *substantial* prospective market impact is necessary to render inside information material and then departed from this standard by dispensing with the requirement of substantiality (HDC Pet. 13; H. Pet. 9–11). We read the phrase "in reasonable and objective contemplation," used by the court below in this case (Pet. App. 87a) and in its earlier decision cited by petitioners (TG Pet. 21), *List* v. *Fashion Parks, Inc.*, 340 F. 2d 457, 462, (C.A. 2), certiorari denied *sub nom. List* v. *Lerner*, 382 U.S. 811, to exclude matters which might cause insubstantial market fluctuations. Moreover, it is difficult to see how investment judgment could be affected without affecting market value.

[35] *Myzel* v. *Fields*, 386 F. 2d 718, 734 and n. 7 (C.A. 8), certiorari denied, 390 U.S. 951; *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (C.A. 1); *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 642 (C.A. 7); accord, *Securities and Exchange Commission* v. *R. A. Holman & Co.*, 366 F. 2d 456, 458, rehearing denied *per curiam*, 377 F. 2d 665 (C.A. 2), certiorari denied, 389 U.S. 991; *List* v. *Fashion Park, Inc.*, *supra*, 340 F. 2d at 462. The Second Circuit has used the first phrasing subsequent to the decision below, with one of the two dissenting judges here joining in the opinion. *Securities and Exchange Commission* v. *Great American Industries, Inc.*, *supra*, 407 F. 2d at 459–466. See also, *e.g.*, *Lehigh Valley Trust Co.* v. *Central National Bank*, 409 F. 2d 989, 993 (C.A. 5); *Northwest Paper Corp.* v. *Thompson*, 421 F. 2d 137, 138 (C.A. 9); *Chasins* v. *Smith, Barney & Co.*, 438 F. 2d 1167, 1171 (C.A. 2). And cf. opinion of Justice Harlan in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384, to the effect that a material fact in a proxy statement is one "of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote."

the two courts of appeals' decisions which petitioners claim are inconsistent with that of the court below (TG Pet. 31–32), one, *James Blackstone Memorial Library Assn'* v. *Gulf, M. & O. R.R. Co.*, 264 F. 2d 445, 450–451 (C.A. 7), certiorari denied, 361 U.S. 815, is an earlier decision of one of the courts which has since specifically adopted the second phrasing (see n. 35, *supra*), and in any event the undisclosed information involved in that case could not possibly have affected the fair market value of the plaintiff's stock.[36] The other, *Sunray Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F. 2d 447 (C.A. 10), does not articulate any standard of materiality, and there is no indication that the drilling results in that case were in any way comparable to the "remarkable discovery" of Texas Gulf (R. 1717; see pp. 8, 13, *supra*);[37] moreover, two of the three judges who decided *Sunray* specifically held that case inapplicable in *Mitchell* v. *Texas Gulf Sulphur Co.*, 446 F. 2d 90, 100 (C.A. 10), petition for certiorari filed (No. 71–421).

In refusing to limit the concept of "reasonable" investors to whom information might be material to long-term, "conservative" investors, the court of ap-

[36] The undisclosed information concerned the possibility that certain property in the corporation's name might be sold to the government at an advantageous price. All the property of the corporation had already been leased to another party in perpetuity, however, and a sale at large profit would not have affected the guaranteed dividend, which is all that plaintiffs were entitled to receive. 264 F. 2d at 447–448, 450.

[37] Neither of the two well holes in the *Sunray* case was on the land where the company had drilling rights; one was more than a mile away. See unreported findings of fact and conclusions of law in the district court, p. 7, No. 68 C 92 (N.D. Okla.)

peals did not depart from the traditional test of materiality, as Texas Gulf suggests (TG Pet. 31). The Act protects speculators as well as conservative investors. Although one of the purposes of the Act was to curb *excessive* speculation, the House Committee Report stated: "There is plenty of room for legitimate speculation in the balancing of investment demand and supply * * *. No investor, no speculator can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells." [38] Certain of the filings with the Commission required under the Securities Act of 1933 relate to securities which would be of interest only to speculators [39] while others describe securities that might appeal to more conservative investors.

Having rejected the test of materiality applied by the district court (see p. 16 *supra*,) the court of appeals in reviewing the district court's decision was not bound, as petitioners contend (HDC Pet. 15–17; H. Pet. 15–17; TG Pet. 36–37), by that court's conclusions as to materiality. This Court has repeatedy held that Rule 52(a) of the Federal Rules of Civil Procedure does not cover findings of fact based upon the application of erroneous legal standards to undisputed eviden-

[38] H. Rep No. 1383, 73d Cong., 2d Sess. 11 (1934).

[39] The Commission has a special registration form for securities of a speculative nature, which must be so labeled. Form S–2, General Instruction D(b), reprinted in 1 CCH Fed. Sec. Law Rep. ¶7142, at 6241–6242; see, also, Form S–3, General Instruction E(b), reprinted in 1 CCH Fed. Sec. Law Rep. ¶7152, at 6262.

tiary facts. *E.g., United States* v. *General Motors Corp.*, 384 U.S. 127, 142 n. 16; *United States* v. *Parke, Davis & Co.*, 362 U.S. 29, 44.[40]

5. All of the judges of the court of appeals sitting *en banc*, as well as the district judge agreed that Section 10(b) and Rule 10b–5 prohibit a corporate insider from trading in his corporation's securities on the basis of important inside information not available to the public. This is also the view of all other federal courts that have considered the matter.[41] Contrary to petitioners' argument that they had no "fair warning" as to this meaning of Rule 10b–5 (TG Pet. 38–39), the Commission has repeatedly expressed this interpretation of its rule in formal adjudications,[42] in

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[40] See generally, 5 Moore's *Federal Practice* ¶52.03[3] and 52.04. The fact that other provisions of the securities acts have been interpreted to contain differing definitions of materiality does not affect the applicable standard in this case (see TG Pet. 30). Cf. *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 466.

[41] *E.g., Myzel* v. *Fields*, *supra*, 386 F. 2d 718; *List* v. *Fashion Park, Inc.*, *supra*, 340 F. 2d 457, 461–462; *Kohler* v. *Kohler Co.*, *supra*, 319 F. 2d 634; *Reed* v. *Riddle Airlines*, 266 F. 2d 314 (C.A. 5); *Cochran* v. *Channing Corp.*, 211 F. Supp. 239, 242–243 (S.D.N.Y.); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), final judgment awarded, 135 F. Supp. 176 (D. Del.), affirmed as modified, 235 F. 2d 369 (C.A. 3); *Kardon* v. *National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa.), modified in other respects, 83 F. Supp. 613 (E.D. Pa.); *Mansfield Hardwood Lumber Co.* v. *Johnson*, 268 F. 2d 317, 319 n. 3 (C.A. 5) (dictum), certiorari denied, 361 U.S. 885; cf. *Strong* v. *Repide*, 213 U.S. 419, 431; and *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 301 N.Y.S. 2d. 78.

[42] The first opinion by the Commission under Rule 10b–5 was issued "to call attention" to the rule and to the Commission's view that it was a violation for insiders, without disclosing a

enforcement actions in the courts,[43] in *amicus curiae* briefs in private actions,[44] and in pamphlets describing its activities to the public and reports to Congress.[45]

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plan to liquidate the corporation at a large premium over the market price of the stock, to cause their corporation to purchase its stock from the minority public shareholders, thereby increasing the value of the insiders' holdings "almost to the same extent as if they had purchased such shares for themselves." *Ward LaFrance Truck Corp.*, 13 S.E.C. 373, 374, 376, 381; *accord*, *R. D. Bayley & Co.*, 19 S.E.C. 773, 784; *Hughes & Treat*, 22 S.E.C. 623, 626 (dictum); *Cady, Roberts & Co.*, 40 S.E.C. 907.

[43] *E.g.*, *Securities and Exchange Commission* v. *First Investment Co.* D.N.H. (Litigation Release No. 281, June 20, 1945); *Securities and Exchange Commission v. Boyd Transfer & Storage Co.* (D. Minn.) (Litigation Release No. 295, Aug. 20, 1945; Litigation Release No. 308, Dec. 7, 1945); *Securities and Exchange Commission* v. *Gentile* (S.D. N.Y.) (Litigation Release No. 323, Feb. 12, 1946); *Securities and Exchange Commission* v. *Redfield* (D. Mass.) (Litigation Release No. 899, Feb. 24, 1955); *Securities and Exchange Commission* v. *Aldred Investment Trust* (S.D. N.Y.) (Litigation Release No. 2081, Aug. 11, 1961). These actions were settled when the violators consented to injunctive relief and, in at least some cases, agreed to make restitution.

[44] *E.g.*, Memorandum of the Commission, *Amicus Curiae*, p. 3, Reply Memorandum of the Commission, *Amicus Curiae*, pp. 4–17, and the Supplemental Reply Memorandum of the Commission, pp. 7–16, in *Speed* v. *Transamerica Corp.*, *supra*, 99 F. Supp. 808.

[45] Securities and Exchange Commission, Work of the Securities and Exchange Commission 8 (1951, 1952, 1954 eds.), 9 (1957, 1960, 1961, 1962, 1964, 1965, 1966 eds.) (title varied in 1964 and 1935 eds.); Securities and Exchange Commission, Thirteenth Annual Report 63–64 (1947), Fifteenth Annual Report 72 (1949); see also "Study of Securities and Exchange Commission," *Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 82d Cong., 2d Sess. 723–726 (1952).

Petitioners do not appear to contend that the corporate employees in question here are not "insiders" as that term has been used in the context of Section 10(b),[46] or that a corporate official, who cannot himself purchase stock without disclosure, may give tips on the basis of the same material information to friends, relatives and business associates so that they can use the information in securities transactions without disclosure.[47] They argue (TG Pet. 33), however, that "[t]he legislative history clearly demonstrates that, absent a showing of fraud or deceit,

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[46] The trial court's holding that "insiders subject to the disclosure requirements of Section 10(b) and Rule 10b-5 may include employees as well as officers, directors, and controlling stockholders who are in possession of material undisclosed information obtained in the course of their employment" (Pet. App. 23a) was unanimously upheld by the court of appeals (Pet. App. 85a-86a, 119a, 128a, 170a). Accord, *e.g.*, *Ross* v. *Licht*, 263 F. Supp. 395 (S.D.N.Y.); 3 Loss, *Securities Regulation* 1450-1454 (2d ed. 1961); Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 Va. L. Rev. 1271, 1280-1282 (1965).

[47] Petitioner Darke, who was found to have violated Section 10(b) and Rule 10b-5 for tipping, does not appear to contend that such a tip would be lawful if given with knowledge that the information was not available to the investing public. See *Kuehnert* v. *Texstar Corp.*, 412 F. 2d 700 (C.A. 5); *Wohl* v. *Blair & Co.*, 30 F.R.D. 82 (S.D.N.Y.); *Ferraioli* v. *Cantor*, 281 F. Supp. 354 (S.D.N.Y.); *Ross* v. *Licht*, 263 F. Supp. 395 (S.D.N.Y); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec. L. Rep. ¶77,629 (S.E.C.); cf. *Investors Management Co., Inc.*, CCH Fed. Sec. L. Rep. ¶78,163 (S.E.C.); *Blyth & Co.*, CCH Fed. Sec. L. Rep. ¶77,647 (S.E.C.); *Herbert L. Honohan* 13 S.E.C. 754, 757-758, modified in other respects, 16 S.E.C. 297; 3 Loss, *Securities Regulation*, *supra*, 1450-1451. See also, *Mosser* v. *Darrow*, 341 U.S. 267, 271-272.

Section 16(b) was designed to be the sole prohibition against insider trading." Section 16(b) provides that a corporation may recover profits realized in short-swing transactions by directors, officers and large stockholders of the corporation regardless of whether they have traded on inside information. As the district court noted at length, there are significant differences between Section 10(b) and Section 16(b) and the provisions of the latter impose no limitation on the former (Pet. App. 20a–26a). Cf. *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80, 91; *Securities and Exchange Commission* v. *National Securities Inc.*, *supra*, 393 U.S. at 465–466. Furthermore, the fact that Congress deleted from an early draft of what became Section 16(b) certain other provisions relating to insider trading does not indicate any lack of concern for the abuse in question here."

"The original bills introduced in Congress not only provided for the recovery of profits from short-swing transactions but also outlawed purchases made with intent to engage in short-swing transactions as well as tips of inside information and provided for the recovery by the corporation of profits from tips. H.R. 7852, S. 2693, § 15(b), 73d Cong., 2d Sess. (1934). At the hearings it was indicated that as written these provisions involved difficult problems of interpretation and proof. *Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720*, 73d Cong., 2d Sess. 133–138 (1934); *Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Con.) and S. Res. 56 and 97 (73 Cong.)* 73d Cong., 1st and 2d Sess. 6556–6561, 6954–6955 (1934); *Blau* v. *Lehman*, 368 U.S. 403, 412 n.12; *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 236 (C.A. 2), certiorari denied, 320 U.S. 751. Thus, the subsequent versions of the bills reported out in both houses omitted these provisions,

As the court of appeals noted (Pet. App. 86a n. 9), the legislative history indicates that "Congress intended by the Exchange Act to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office." Indeed, the Senate Report stated: "Among the most vicious practices unearthed * * * [in the legislative hearings] was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities."[*] This legislative history indicates that the power delegated to the Commission in Section 10(b) to define "any manipulative or deceptive device or contrivance" includes the power to prohibit a wide range of abuses in the area of insider trading.

Petitioners imply (TG Pet. 34) that the use of inside information for trading activities should not be unlawful if those activities are carried out in an anonymous exchange market. Such a limitation, as the Second Circuit has previously indicated, "would be

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and the House version even omitted what is now Section 16(b). H.R. 9323, § 15, S. 3420, § 16, 73d Cong., 2d Sess. (1934); the Senate version of what is now Section 16 was accepted in conference, H.R. Rep. No. 1838, 73d Cong., 2d Sess. 35-36 (1934), and enacted, apparently on the premise that the imposition of liability without any showing of abuse of inside information went beyond even the broad rulemaking powers given to the Commission.

[*] S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). This language is contained in the section of the report dealing with "Market Activities of Directors, Officers, and Principal Stockholders of Corporations."

contrary to the intent of Congress, as set forth in Section 2 of the Securities Exchange Act, 15 U.S.C. § 78b, which was to regulate 'transactions in securities as commonly conducted upon securities exchanges [as well as] over-the-counter markets.'" *List* v. *Fashion Park, Inc., supra,* 340 F. 2d at 462.[80] Indeed, disclosure is perhaps most important in impersonal transactions, such as those carried out on a stock exchange, because the stockholder who deals with an insider on a face-to-face basis has an opportunity to make informal inquiry whether the insider is in possession of any material information not available to the public.[81] As the court of appeals pointed out, abuse of inside information allows insiders to obtain "secret corporate compensation * * * at the expense of the uninformed investing public * * *. Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in

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[80] The *List* opinion also answered petitioners' contention that purchases of stock on a national securities exchange on the basis of material inside information do not induce other investors to sell their stock at that time (TG Pet. 34–35), pointing out that the concept of reliance is not limited to a situation in which the investor

> actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. * * * The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact. * * *

340 F. 2d at 463. Accord, *Myzel* v. *Fields, supra,* 386 F. 2d at 735.

[81] Cf. *Broffe* v. *Horton,* 172 F. 2d 489, 494 (C.A. 2).

view of the congressional concern in this area, remain uncorrected" (Pet. App. 92a–93a).

6. With respect to the question of remedy, petitioners contend that in a suit brought by the Commission, the district court could grant no more than an injunction and that it was without power to order restitution and other relief (HDC Pet. 12–20; TG Pet. 40–41). This Court has held, however, that the grant of jurisdiction in Section 27 of the Securities Exchange Act permits the courts to grant appropriate remedies to effectuate the purposes of the Act and to deter future violations thereof. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 386; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433–435; accord, *Deckert* v. *Independence Corp.*, 311 U.S. 282; cf. *Textile Workers Union* v. *Lincoln Mills*, 353 U.S. 448. In other contexts the Court has upheld the power of the government to seek, and the courts to grant, restitution as an ancillary remedy in spite of the absence in the statutory language of "affirmative confirmation of the power to order reimbursement." *Mitchell* v. *DeMario Jewelry*, 361 U.S. 288, 291–292; accord, *Porter* v. *Warner Holding Co.*, 328 U.S. 395; see also *Sullivan* v. *Little Hunting Park*, 396 U.S. 229, 239; *Jones* v. *Alfred H. Mayer Co.*, 392 U.S. 409, 414 and n. 13. In fact, the court may grant restitution even though injunctive relief is neither sought nor granted. See *United States* v. *Moore*, 340 U.S. 616, 620, n. 6.[22]

[22] Section 21(e) of the Act, which refers only to injunctive relief, does not limit the Commission's authority to invoke the courts' general equity powers to afford complete relief. See *e.g.*, *Lankenau* v. *Coggeshall & Hicks*, 350 F. 2d 61 (C.A.

"An order of restitution is not a judgment for damages or for penalties. It compels compliance and is restorat[ive] of the status quo which falls within the recognized power of a court of equity." *Bowles* v. *Skaggs,* 151 F. 2d 817, 821 (C.A. 6); accord, *e.g., Mitchell* v. *DeMario Jewelry, supra,* 361 U.S. at 293; *Schine Chain Theatres, Inc.* v. *United States,* 334 U.S. 110, 128. Petitioners here were "merely deprive[d] * * * of the gains of their wrongful conduct" (Pet. App. 228a–229a).[53] *Ibid.* Indeed, the formula employed by the court permitted petitioners to retain profits accruing after April 17, 1964 (the day following the announcement that Texas Gulf had a "major strike"). With respect to Mr. Darke, who was held liable for the profits of his tippees, the court recognized that "more of a hardship is imposed" on

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2); *Los Angeles Trust Deed & Mortgage Exchange* v. *Securities and Exchange Commission,* 285 F. 2d 162, 181–182 (C.A. 9), certiorari denied, 366 U.S. 919; see generally J. W. Wade and R. D. Kamenshine, *Restitution for Defrauded Consumers: Making the Remedy Effective Through Suit by Governmental Agency,* 37 Geo. Wash. L. Rev. 1031, 1048–1056 (1969). Indeed, the Commission has obtained restitution or rescission in other cases. See, *e.g., Securities and Exchange Commission* v. *Golconda Mining Co.,* CCH. Fed. Sec. L. Rep. ¶93,058 (S.D. N.Y.); *Securities and Exchange Commission* v. *Wong,* 252 F. Supp. 608, 613–614 (D.P.R.). This is consistent with *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.,* 320 U.S. 344, 350–351, where this Court declined to invoke the concept of *expressio unius est exclusio alterius* to limit the scope of securities legislation.

[53] The court of appeals rejected petitioners' contentions that a penalty was involved because under the judgment Texas Gulf might retain the fund even though it was not damaged

him,[54] but "without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information"[55] since the transaction "could be concluded by a relative or an acquaintance * * * or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given" (Pet. App. 229a). Cf. *Mosser* v. *Darrow*, 341 U.S. 267, 271–272.[56]

7. Finally petitioners make a number of constitutional and procedural arguments which we submit are without merit. Texas Gulf contends that the court of appeals' determination that the issuance of a false press release may violate Section 10(b) of the Securities Exchange Act contravenes the First Amendment (TG Pet. 27–30). In *Donaldson* v. *Read Magazine,*

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by this breach of fiduciary duty (Pet. App. 229a–230a). "[T]he primary concern, in a case such as this, is not to determine whether the corporation has been damaged but to decide, as between the corporation and the defendants, who has a higher claim to the proceeds derived from the exploitation of the information." *Diamond* v. *Oreamunó*, *supra*, 24 N.Y. 2d at 498, 499, 301 N.Y.S. 2d at 81–82. Nevertheless, the corporation, which has "a great interest in maintaining a reputation of integrity, an image of probity, for its management and in ensuring the continued public acceptance and marketability of its stock," is injured by their conduct. *Ibid.*

[54] The district court did not charge Mr. Darke with the profits of his tippees' tippees and the Commission did not appeal from that ruling (Pet. App. 206a–207a).

[55] Section 20(b) of the Act, 15 U.S.C. 78t(b), specifically makes it "unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under * * * [the Act] through or by means of any other person."

[56] The district court did not abuse its discretion in enjoining Messrs. Crawford and Clayton since, as the court of appeals noted, there was "sufficient distinction in [their] cases for the district court to single them out" (Pet. App. 225a).

Inc., 333 U.S. 178, 190, however, this Court stated that the "governmental power" utilized in the Securities Exchange Act and other specified antifraud statutes in making false statements unlawful "has always been recognized in this country and is firmly established." *Donaldson* upheld the validity of an order depriving respondents "of a right to speak or print * * * to the extent necessary to protect others from * * * fraudulent artifices." 333 U.S. at 191. While a tolerance for negligence by conduits of information and topical views (such as newspapers and pamphleteers) may be necessary to assure a free flow of ideas,[37] the protection of the investing public from material misstatements by corporate officials affecting the market value of the corporation's publicly-traded stock clearly outweighs any "right" of these officials to make public statements without exercising due diligence in determining their accuracy.[38] Accordingly,

[37] See, *e.g.*, *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 278–279; *Rosenbloom* v. *Metromedia, Inc.*, 403 U.S. 29.

[38] Some courts have questioned whether commercial speech, such as that involved here, involves issues "about which information is needed or appropriate to enable the members of society to cope with the exigencies of their period," *Thornhill* v. *Alabama*, 310 U.S. 88, 102, as Texas Gulf asserts (TG Pet. 29). See, *e.g.*, *Valentine* v. *Chrestensen*, 316 U.S. 52; *New York State Broadcasters Assoc.* v. *United States*, 414 F. 2d 990, 996–997 (C.A. 2), certiorari denied, 396 U.S. 1061 *Banzhaf* v. *Federal Communications Commission*, 405 F. 2d 1082, 1101–1102 (C.A. D.C.), certiorari denied *sub nom. Tobacco Institute* v. *Federal Communications Commission*, 396 U.S. 842; cf. *Curtis Publishing Co.* v. *Butts*, 388 U.S. 130, 150; *Breard* v. *City of Alexandria*, 341 U.S. 622, 642; *Murdock* v. *Pennsylvania*, 319 U.S. 105, 110–111; *Martin* v. *City of Struthers*, 319 U.S. 141, 142 n.1.

the court below correctly held (Pet. App. 224a-225a) that, in balancing unfettered corporate or commercial speech against injury to the public resulting from misleading or fraudulent corporate press releases, such commercial speech is not entitled to constitutional immunity. *Securities and Exchange Commission* v. *Wall Street Transcript Corp.*, 422 F. 2d 1371, 1379–1380 (C.A. 2), certiorari denied, 398 U.S. 958. See also, *United States* v. *Amick*, 439 F. 2d 351, (C.A. 7), certiorari denied, No. 70–134, Oct. 12, 1971; *Securities and Exchange Commission* v. *May*, 229 F. 2d 123 (C.A. 2); *Halsted* v. *Securities and Exchange Commission*, 182 F. 2d 660, 668 (C.A.D.C.).

Petitioners argue that in contravention of "the Fifth Amendment and well-settled principles of administrative procedure" (TG Pet. 38; H Pet. 18; HDC Pet. 23; C Pet. 26–27), Rule 10b–5 afforded them insufficient warning of the conduct it proscribes. But, as we have pointed out (pp. 36–37, *supra*), the prior consistent administrative and judicial interpretations of that rule furnished petitioners with ample notice that the rule proscribed the activities they engaged in. Cf. *Jordan* v. *DeGeorge*, 341 U.S. 223, 231–232. Where deceptive activity is involved, this Court has warned that "to define strictly the species or evidences of it," would result in jurisdiction over such activity being "perpetually eluded by new schemes which the fertility of man's invention would contrive." [59] Moreover,

[59] *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 193 n. 41, quoting from letter of Lord Hardwicke to Lord Kames, dated June 30, 1759.

this Court has recognized that "the choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency." *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 203.[60]

Petitioners also argue (C Pet. 12; TG Pet. 41; H Pet. 19) that they were entitled to oral argument after the lower court determined to decide the case *en banc*. On May 2, 1968, three months prior to its decision in this case, the court of appeals advised the parties that "* * * the appeal [would] be considered in banc by all the active judges of the Court upon the record and the briefs [t]heretofore filed, and the opinions written by the judges who heard the argument of the appeal, without further argument" (C.A. 2, Docket No. 30882). No motion for leave to present additional oral argument was made by any of the parties at that time. Thus even if petitioners had a right to be heard orally by the full panel of court below, it would appear that they waived this right. In any event, no such "right" (C. Pet. 19) is an element of due process. *Federal Communications Commission* v. *WJR*, 337 U.S. 265, 275. Nor does Section 46(c) of Title 28 of the United States Code or the Federal Rules of Appellate Procedure, upon which petitioners rely (C.

[60] Cf. *National Labor Relations Board* v. *Wyman-Gordon Co.*, 394 U.S. 759, 771–772 (opinion of Mr. Justice Black); *Columbia Broadcasting System* v. *United States*, 316 U.S. 407, 421. As this Court made clear in *Chenery*, *supra*, the fact that proceeding by litigation "might have a retroactive effect" is "not necessarily fatal to its validity." 332 U.S. at 203.

Pet. 12–22), provide that parties have a "right" to oral argument before the full court. This Court has repeatedly stated that:

> § 46(c) is not addressed to litigants. It is addressed to the Court of Appeals. It is a grant of power. It vests in the court the power to order hearings *en banc*. It goes no further. * * * [61]

While Rule 34 of the Federal Rules of Appellate Procedure provides for oral argument, Rule 2 authorizes a court of appeals to "suspend the requirements or provisions of any of these rules in a particular case * * * on its own motion and [to] order proceedings in accordance with its direction."

Petitioner Crawford also urges (C Pet. 30–32) that the use of the words "material" and "disclosed" in the permanent injunction entered against him are unconstitutionally "vague" and "subjective." In support of this contention he points to purported differences between the court of appeals and the district court in deciding what was material in this case. There was no such difference, however, with respect to the activities of Mr. Crawford, who knew that the April 16 press release that was about to be issued contained material information which had not been disclosed publicly when he made his purchases of

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[61] *Western Pacific R.R. Corp.* v. *Western Pacific R.R. Co.*, 345 U.S. 247, 250. This language was quoted in *Shenker* v. *Baltimore & Ohio R.R. Co.*, 374 U.S. 1, 4–5, where it was held that a court of appeals' rule limiting *en banc* consideration only where voted by each of the active circuit judges would be sustained despite the language in the statute to the effect that "a hearing or rehearing before the court in banc * * *" might be "ordered by a majority of the [active] circuit judges * * *."

Texas Gulf shares (see pages 13–14, *supra*). By virtue of the *en banc* opinion of the court of appeals, Mr. Crawford has at least as much guidance as to the appropriate meaning of the word "material" as he would have with respect to the application of that word in federal criminal statutes dealing with perjury and false filings. See 18 U.S.C. 1621 and 1001.

The additional constitutional arguments raised by various of the individual petitioners (HDC Pet. 22–23) are based on the assumption that the relief granted by the district court constituted a penalty. As we have seen, pages 43–44, *supra*, this is not so.

CONCLUSION

For the foregoing reasons, the petitions for writs of certiorari should be denied.

Respectfully submitted.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

Docket No. 71-347

WALTER HOLYK, KENNETH H. DARKE and
RICHARD H. CLAYTON,

Petitioners,

-against-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Introductory Statement

In the main, the petition of Messrs. Clayton, Holyk and Darke consider the issues raised by the SEC in its opposing brief. Thus, this reply will be limited to the issues

raised by the SEC regarding the question of remedy and, in particular, the remedy created to impose liability on Mr. Darke for profits made by others, the so-called "tippees". These issues concern questions of first impression which, we submit, should be resolved after a full review by this Court.

I

The issue concerning Mr. Darke's liability for profits of others.

The SEC, in its opposing brief, offers no independent justification for the order requiring Mr. Darke to make "restitution" for profits derived by his "tippees", profits in which Mr. Darke did not share (SEC Br. pp. 43-44). In support of this novel requirement, the SEC simply reiterates the language of the Court of Appeals (Pet. App. 229a; SEC Br. pp. 43-44). While this form of argumentation may be construed as a remarkable display of discretion, it may also be construed as an inability to provide legal justification for the creation of a remedy beyond the pale of the court.

The paragraph of the Court of Appeals opinion, from which the SEC quoted all but a few unessential words, reads:

> "As to the requirement that Darke make restitution for the profits derived by his tippees, admittedly more of a hardship is imposed. However, without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information. Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (Pet. App. 229a)
> (Emphasis added)

The Court in devising this restitutionary requirement presumably acted under its general equity powers (Pet. App. 227a-228a), but nowhere does the Court cite any authority to show that an equity court has the power to compel one person to answer for the gains of another. Research of cases concerning restitution has disclosed no case where a person was required to return other than that which he wrongfully acquired. We submit that the requirement imposed on Mr. Darke cannot be characterized as restitution and must be characterized as a penalty.

The Court of Appeals rationalized its newly created remedy by saying "without such a remedy, insiders could

easily evade their duty to refrain from trading on the basis of inside information" (Pet. App. 229a). This contention, however, is merely a supposition without any factual basis in the record. This is apparent from the immediately following sentence which reads:

> "Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (Pet. App. 229a)

None of the hypothetical situations against which the Court seems to be guarding are present here. But even if they did exist, it would be totally irrelevant, because the supposition that the remedy created is necessary to prevent insider trading in the described situations is not valid. The SEC is equipped to prevent this type of trading by seeking criminal sanctions against both tippor and tippee under Section 32(a) of the Act and injunctive relief under Section 21(e).* Judicial legislation, therefore, is not required to supplement these remedies nor is it desirable.

We submit that the remedy created to foist liability on Mr. Darke for profits of tippees cannot be justified on equitable principles nor principles of statutory

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* Securities Exchange Act of 1934, Section 32(a) (Pet. App. p. 237a); Securities Exchange Act of 1934, Section 21(e) (Pet. App. p. 236a).

construction. Moreover, the imposition of such an onerous liability should not be countenanced where the predicate for liability is based on a slight burden of proof.

In this enforcement proceeding, the SEC from the outset contended that it need not prove all the elements required in a suit for monetary damages (SEC Br. 27-28). This contention has been sustained with the result that the SEC has only borne the slight evidentiary burden required in prophylactic actions. Yet the order requiring Darke to pay tippees' profits, an order which at the very least is based on legal and not equitable principles, was based on the prophylactic burden of proof and not the burden required in a monetary damage action. We submit that before the principles of equity, as espoused by the SEC, embark on a new course, this Court grant a full review of the issues.

II

Issue of authority to grant other than injunctive relief.

Neither the SEC nor the courts below cited any authority directly supporting the power of the SEC in an enforcement proceeding to request, and the court to grant, relief other

than injunctive relief provided in Section 21(e). We concede that a court has the power to grant ancillary relief to assure the effectiveness of orders which it is authorized to make. For example, the appointment of a receiver to insure that the terms of its injunctive order will be effectuated. However, the employment of ancillary relief in connection with statutorily authorized injunctive relief cannot serve as a predicate for the granting of relief unconnected with injunctive relief.

To support the granting of non-ancillary relief the SEC and the courts below cited (a) civil actions under Section 27 of the Securities Exchange Act, i.e., Mills v. Electric Autolite Co., 396 U.S. 375 (1970) where appropriate relief would have to be fashioned by the court if the statute was to be effective; (b) actions under the Housing and Rent Act or the Emergency Price Control Act, i.e., United States v. Moore, 340 U.S. 616 (1951) where the statute authorized the issuance of "other orders" separate and distinct from injunctive orders; and (c) actions under the antitrust laws, i.e., Shine Chain Theatres, Inc. v. United States, 334 U.S. 110 (1948) involving an order of divesti-

ture where the violator received full consideration for property divested. The only pertinent case, as we stated in our petition, is Mitchell v. De Mario Jewelry, 361 U.S. 288 (1960).* There this Court approved of a payment order, for which no statutory provision was expressly made, on the grounds that such order was essential to effect the purposes of the statute under consideration. No such finding of necessity has been made in this case to justify a rejection of the plain wording of Section 21(e). Indeed, no facts were submitted in support of a finding of necessity. Accordingly, we submit that before Section 21(e) is effectively replaced by Section 27, and Section 32(a) relegated to oblivion, this Court grant a full review of the issues regarding the authority of courts to fashion remedies other than those provided by statute.

CONCLUSION

For the foregoing reasons, this petition for a writ of

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* Discussed at pages 11-20 in the Petition of Messrs. Clayton, Darke and Holyk.

certiorari should be granted.

November 23, 1971

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PETITION FOR REHEARING

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IN THE

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OCTOBER TERM, 1971

DOCKET NO. 71-347

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RICHARD H. CLAYTON,

Petitioners,

—against—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

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IN THE

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SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

Introductory Statement

Petitioners respectfully move this Court for an order vacating the denial of their petition for writ of certiorari, entered on December 20, 1971, and granting such petition. In support of this motion, petitioners state the following:

I

This Petition May Be Considered By The Full Court of Nine Justices

The petition for certiorari was denied on December 20, 1971, with Justice Blackmun dissenting.* Since then, two new Justices have become members of this Court. The full Court now has an opportunity to consider whether the remedy invoked to punish Kenneth Darke is legally sustainable.

Rule 58(2) of this Court provides that a petition for rehearing of an order denying certiorari may be filed where substantial grounds exist that were not previously presented to this Court. The grounds upon which petitioners rely are hereinafter set forth in point II. They concern three elements interwoven in the manifold decisions below and obfuscated by the plethoric comment attendant the Texas Gulf Sulphur case. These elements are: (i) Kenneth Darke, an individual, who unknowingly violated a law, lacking in clarity, from which violation he received no benefit; (ii) a violation of the securities law which is based on evidentiary findings challenged by the author, Judge Waterman, of the very Court of Appeals opinion which determined the violation; and (iii) a remedy created without precedent, but justified as necessary to cure insider conspiratorial conduct and applied here where no conspiratorial conduct was alleged or proven.

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* Justice Blackmun was of the opinion that certiorari should be granted to consider the order requiring Mr. Darke to restore profits made by tippees and the order enjoining Mr. Clayton.

II

This Court Should Reconsider The Basis For The Harsh Penalty Imposed on Kenneth Darke

The rights of Kenneth Darke have been submerged in the backwash of the resolution of issues of *major* importance to the financial community, the investing public and the SEC and, without this Court's aid, will be irrevocably lost. In focusing on the novel issues in the Texas Gulf Sulphur (TGS) litigation, the courts have cursorily treated the minor ones involving Mr. Darke, a relatively insignificant individual in the entire complex and exhaustive proceedings. Yet he is the one to whom the most severe punishment was meted out and, in our opinion, a victim of the gravest injustice.

Kenneth Darke has been ordered to "restore" $48,404.58 to TGS. This sum represents profits made by others purportedly on his recommendation to buy TGS shares. Kenneth Darke did not receive one cent of this amount or any other cognizable benefit from those who purchased TGS shares. Nonetheless, the court, without statutory authority or judicial precedent, has ordered Darke to personally pay such amount to TGS, and that order will go undisturbed if not modified by this Court.*

$48,404.58 is a large sum to some individuals and a staggering sum to most. If Mr. Darke is required to pay this penalty, he will be indentured to TGS for the remainder of his life. Fundamental principles of justice require that

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* This Court in *Reliance Electric Company* v. *Emerson Electric Company*, 40 L. W. 4125 (1972) circumscribed the court's authority to go beyond the express language of the Securities Exchange Act of 1934 to recapture profits made by insiders. In ordering Mr. Darke, an insider, to restore tippees profits, the courts below greatly exceeded the bounds established by this Court in *Reliance*.

before this indentured state becomes a reality, the decision mandating this payment be closely scrutinized by this Court. This is especially so where, as here, an average person is caught in the gossamer web of governmental and judicial pronouncements in a rapidly expanding and highly sophisticated area of law; where liability is imposed without any direct evidence and upon only the flimsiest of circumstantial evidence; and where the court's stated justification for the remedy created has no application to the facts of this case.

Kenneth Darke was employed by TGS as a geologist; he was not an officer or director. His skills were practiced in the most remote areas of this hemisphere. This alone would suffice to render him unfamiliar with our securities laws and regulations without adding the fact that he is a resident and citizen of Canada.* The case against Mr. Darke turned on the fact that two persons, to whom he had recommended TGS shares as "a good buy" in December 1963, purchased TGS shares, together with a few of their acquaintances, on *March 30, 1964.* Neither Kenneth Darke nor any other person was called to testify at the trial regarding the facts surrounding the alleged violations by Mr. Darke. The only material introduced into the record on the trial were the depositions of Mr. Darke (Jt. A. 1694a)**; Nancy A. Brown (formerly Atkinscn) (Jt. A. 1605a); Madge B. Caskey (Jt. A. 1622a); Herbert W. Klotz (Jt. A. 1636a); and Stanley I. Westreich (Jt. A. 1650a).

Nancy A. Brown and her mother, Madge B. Caskey, were friends of Mr. Darke to whom he recommended TGS shares

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* Ignorance of the law, while concededly no defense in a criminal proceeding, should be a factor in determining a remedy in an equitable proceeding.

** "Jt. A." refers to the Joint Appendix of the Court of Appeals, a copy of which has been filed in this Court.

as "a good buy" for reasons totally unconnected with the TGS drilling results (Jt. A. 1698a-1702a). Messrs. Klotz and Westreich were friends of Nancy Brown and did not know Mr. Darke. Each person, including Mr. Darke, testified that no information regarding the drilling results was made available. No rebuttal evidence was submitted by the SEC.

A perusal of the depositions fails to disclose a scintilla of evidence to indicate that Kenneth Darke told anyone about the TGS drilling results. Indeed, Judge Waterman, who wrote the majority opinion in the first Court of Appeals decision, and Judge Anderson, concurring, did not believe that there had been any finding by the district court as to whether Mr. Darke, "expressly or by implication, transmitted to these outsiders and indication of the extremely favorable results of the drilling operation in which he was engaged. . . ." * (App. 94a fn. 16).**

The Court of Appeals, in its first decision, swept away the direct evidentiary findings of the district court (App. 33a), concentrating its vision on the district court's statement that the purchases on March 30, 1964, were strong circumstantial evidence that Darke must have passed the word to one or more of his tippees that "drilling on the Kidd 55 segment was about to be resumed." Building on this circumstantial evidence, the Court of Appeals then added a circumstantial finding of its own. It said "if such a resumption were to have any meaning to such 'tippees', they must have previously been told of K-55-1." (App. 94a)*** These conclusion were drawn without any direct evidence

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* Chief Judge Lombard and Judge Moore, of course, did not find any liability (129a-173a).

** "App." refers to petitioners' appendix in No. 71-327.

*** If Mr. Darke did communicate on March 30, why didn't he communicate on April 9, when the results were more definitive and extremely favorable.

that Mr. Darke communicated the resumption of drilling to his tippees or, as Judges Waterman and Anderson noted, anything about the drilling results. Hence, on the slender reed of purchases on March 30, 1964, liability was imposed on Kenneth Darke.

However slender the reed to impose liability, absolutely no meaningful basis was proffered for holding Mr. Darke accountable for the profits of others. Nowhere in our system of jurisprudence, apart from the law of agency, has anyone been held responsible for the acts of others unless he was acting in concert with them or knowingly acting in violation of the law. Neither condition obtains here. The Court of Appeals in its second decision acknowledged the hardship to Kenneth Darke by the payment order, but swiftly justified it saying:

> "without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information. Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." (App. 229a)

This justification has absolutely no application to the facts of this case. If an insider were to trade, as the court suggests, through a friend or acquaintance, or with implied mutually beneficial understandings, such transactions would constitute a conspiracy. Holding the tipper liable for tippees profits derived from a conspiratorial scheme is well recognized under existing principles of law. But no such allegation of conspiracy can be found in the complaint, nor can any facts of a conspiracy be gleaned from the direct or circumstantial evidence introduced at the trial. Thus for the court to fashion and apply a

remedy designed to cure conspiratorial conduct to this case, where no conspiracy exists, is clearly erroneous.

When the heat of the courtroom battle subsides and the final decision is rendered, it remains for the result to be tested by the sound principles of law or equity developed over the past centuries. This test is not met in this equitable proceeding, where no principle has been enunciated to rationalize, or precedent cited to support, a result which on its face is unfair, unjust, and destructive of personal rights. Before we embark on a new tenet of law which subjugates an individual to unconscionable debt, this Court should pass on it.

CONCLUSION

For these reasons, as well as those contained in the petition for a writ of certiorari, petitioners pray that this Court grant rehearing of the petition, and order a review of the judgments and opinions below.

Dated: January 14, 1972

Respectfully submitted,

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Certificate of Counsel

As counsel for the Petitioners, I hereby certify that the petition for rehearing is presented in good faith and not for delay, and to the extent described above, is restricted to the grounds specified in Rule 58(2).

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Attorney for Petitioners